No. 75-679

In the Supreme Court of the United States

OCTOBER TERM, 1975

INTERNAL REVENUE SERVICE, PETITIONER

v.

FRUEHAUF CORPORATION, ET AL., RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

SUPPLEMENTAL APPENDIX TO BRIEF FOR THE RESPONDENTS

JOHN L. KING
MATTHEW C. MCKINNON
2600 Detroit Bank & Trust Bldg.
Detroit, Michigan 48226
MILTON J. MEHL
2012 Continental Life Bldg.
Fort Worth, Texas 76102
WILLIAM A. BARNETT
135 S. LaSalle Street
Chicago, Illinois 60603
GERALD C. RISNER
135 S. LaSalle Street
Chicago, Illinois 60603
GEORGE D. WEBSTER
1747 Pennsylvania Ave., N.W.
Washington, D. C. 20006

Attorneys for Respondents

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

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APPENDIX

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

ALLSTATE INSURANCE COMPANY,

Plaintiff

v.

UNITED STATES OF AMERICA,

Defendant

Civil Action No. 60-C-322

DOCKET ENTRIES

3/ 1/60	Filed complaint and 5 copies	mg
3/ /60	Issued Summons and 5 copies with 5 copies of complaint (JS 5)	sw
3/ 9/60	Filed Summons. Retd servd as to US Atty. (1 serv)	$2.00 Ej
5/ 2 60	Filed Answer	(4) H
1/ 9/61	Filed Notice and Motion for lv to file amended complaint	(2)(2)
1/ 9/61	Enter order motion for lv to file amended complaint instr. granted—Perry, J. (DRAFT)	(1)
1/ 9/61	Filed Amended Complaint and Exhibits	(11, E
2/ 3/61	Enter order to extd time for filing Gvts Answer to the Amended Complt to and incl. Feb 23, 1961 by agreemt granted.—Perry, J. Mld ntcs 2-8-61	Ej
2/23/61	Filed answer to amended complaint	(4) t

9/11/61 Leave to pltff to fl mo for summ judgt instr. Govt to file answer thereto within 15 days. Briefs 20-20 anf 10.—Perry, J.
Mailed notices. 9-14-61 ht

9/11/61 Filed Motion for summary judgment and Affidavit in support thereof. (2, 9)ht

9/11/61 Filed Entry of appearance of addl. counsel (1) ht

9/26/61 Filed Defendant's Cross Motion for summary judgment and affidait (2, 1) E

10/ 9/61 Fld Stipulation. (1) I

10/10/61 Filed Notice of Motion, Plaintiff's Motion for continuance to permit deposition to be taken and Affidavit. (2,2,2) ht

10/17/61 By agrmt motion for summary judgment proceedings contd to Oct. 23, 1961—Parsons, J.
Mld ntcs 10-26-61. H

10/23/61 Plff given until Nov. 6, 1961 to file brief as to admissibility of assertions in affidavit, deft given until Nov. 13, 1961 to answer. Hearing on briefs set for Nov. 20, 1961—Parsons,J.
Mld ntcs 11-8-61. t

11/ 6/61 Filed Brief in support of pltff's motion to strike. & Certif of Service wek

11/ 6/61 Filed Stipulation & Certificate of Service (2) ht

11/10/61 Motion to strike affidavit of asst. commissioner Schwartz denied. Hearing on compliance of affidavit set for 12-11-61; Parsons: n.m. 11-28-61. O

11/14/61 Enter order for leave to file brief for the Deft. in opposition to Pltffs. motion to strike affidavit of assistant commissioner—Parsons, J.
Mld. ntcs 11-29-61. sw

11/14/61 Filed brief for the Deft. in opposition to Plaintiff's motion to strike affidavit of assistant commissioner. (25) EH

11/17/61 Filed Certificate of Service. ht

11/17/61 Filed pltff's reply to brief for the deft. in oppsn to pltffs motion to strike affidavit of assistant commissioner. ss

12/11/61 Mo of pltff to strike affidavit of deft allowed. Cause contd to Jan. 5, 1962 for report on status & to set for trial—Parsons, J.
Mld ntcs 12/20/61 sp

12/19/61 Clerk's File Copies of Transcript of Proceedings had before Judge Parsons on Nov. 20, 1961 and Dec. 11, 1961 filed by official court reporter.

9/22/61 Reassigned Judge Parsons (43) (14) ht

1/ 2/62 Filed Deposition of Harold T. Swartz.

1/ 4/62 Filed Notice of motion and Pltffs motion for production of documents. (2,9) ht

1/ 5/62 Leave to plntff. to amend motion for production of documents, instanter. Deft. given until Jan. 10, 1962 to file brief in opposition to plntff's. motion to produce and affidavit of Commissioner of Internal Revenue. Plntff. to file concurrent brief on executive privilege issue.

Hearing on plntff's motion for production of documents set for Jan. 11, 1962 at 2 P.M. Parsons, J. p
Mld. Ntcs. 1/19/62.

1/11/62 Lv gv pltff to suggest voluntarily question of conflict of interest of its own counsel; Court referred matter to Dept of Justice for review & recomm. Lv. gv pltff to file affidavits showing

no conflict of interest. Gov reports on its review of matter & suggested its finding of no conflict of interest in accord with government's finding & lv gv attys for pltff to proceed in cause. Deposition of Harold T. Swartz filed of record taken as evid in supp of deft's mo for summary judgt. Pltff files exhibits AB&C in evid, in opposition. Govt gv until Feb 5, 1962 to file brf in supp of its mo for summary judgt. Pltff gv until Feb 19, 1962 to file ans brf. Gov gv until Feb 26, 1962 to file reply brf. Cs cont'd for further hrg on mo for summary judgt & ruling on March 15, 1962—Parsons, J.

Mld ntcs 1/24/62. sp

1/11/62 Filed Deft's brief in opposition to plntff's motion to produce. p

1/11/62 Filed Affidavit of William Cromartie. p

1/11/62 Filed Affidavit of Charles W. Davis. p

1/10/62 Filed Plaintiff's brief iln; opposition to deft's claim of executive 28 pp. plus certificate of service, 1 p. SB

2/ 2/62 On joint motion of counsel for pltf and deft. this Court's Minute Order dated Jan. 11, 1962 is hereby amended, nunc pro tunc, to read as follows: Leave given to plaintiff to suggest voluntarily, question of conflict of interest of its own counsel; Court referred matter to Department of Justice for review and recommendation. Leave given to plaintiff to file addits showing no conflict of interest. Government reports on its review of matter and suggested its Finding of no Conflict of interest; order entered finding

no conflict of interest in accord with Government's finding, and leave given to attorneys for the plaintiff to proceed in cause. Deposition of Harold T. Swartz, filed of record taken as evidence in support of defendant's motion for summary judgment, subject to plaintiff's objections as to competence and relevancy. Plaintiff files exhibits A, B and C in evidence, in opposition. Government given until February 5, 1962 to file brief in support of the existence of the asserted administrative practice. Plaintiff given until Feb. 19, 1962 to file answering brief. Government given until Feb. 26, 1962 to file reply brief. Cause contd to March 15, 1962 for further hearing and ruling on competency of Govt's. evidence to prove existence of asserted administrative practice.—Parsons, J.

Notices mailed. Draft (2) ht

2/ 5/62 Fld. Brief for the deft. in support of its proof of Administrative Practice. p

2/21/62 Fld motion, certificate of service. (1)(1)

2/19/62 Fld brief for plff in opposition to compliance and relevance of evidence offered by Govt to prove administrative practice. co

2/21/62 Order that the time to file Govt's reply brief extd to March 5, 1962 DRAFT (1,2) Parsons, J. t Mld ntes 3/6/62.

3/ 5/62 Fld supplemental brief for deft in support of its proof of administrative practice. t

1/23/62 Clerks file Copy of Transcript of Proceedings had on 1-11-62 before Judge Parsons filed by official Court Reporter. (74)

2/20/62 Pur. to order ent'd letter of Department of Justice, dated Feb. 7, 1962, addressed to this Court, be filed in the record of this case as additional statement of the govt in support of its position taken relative to counsel representing Allstate Insurance Co. DRAFT Parsons, J. t Ntes mld.

2/28/62 Clerk's File Copy of Transcript of Proceedings had on Jan. 5th 1962 before Judge Parsons filed by Official Court Reporter. (50) E

3/15/62 Filed plaintiffs reply to supplemental brief for the deft in support of its proof of Adminis. practice. sp

3/15/62 Lv granted pltff to file instanter its reply to defts supplemental brief in support of its proof of administrative practice. Order cause contd for hearing on admissibility of govt's proof in support of administrative practice on March 28, 1962 at 2:00 P.M.—Parsons,J. E

Mld Ntes 3-16-62. D

3/20/62 Filed Stipulation concerning certain corrections to be made in the transcript of the deposition of Harold T. Swartz.

3/26/62 On motion of the Govt. order cs reset for argument on April 10, 1962 at 2:00 P.M.—Parsons, J. E

Mld Ntes. 3-29-62. D

4/ 6/62 On courts own motion cs reset for hrg on admissibility of Governments proof in support of administrative practice on April 17, 1962 at 2:00 P.M.—Parsons, J. E

Mld. Ntes. 4-9-62. D

4/17/62 Arguments on admissibility of govt's proof in support of administrative practice heard & concluded. Matter taken under advsmt. Parsons, J. p

Mld. Ntes. 4-18-62. ed

4/26/62 Filed Clerks Copy of Transcript of Proceedings had on 4-17-62 of Official Court Reporter. JMD

7/31/62 Pursuant to memo opinion and order ent objections of Allstate Ins Co to the admission of Schwartz deposition and letter rulings into evidence are overruled. Trial briefs will be filed by the parties on the merits of the case and cause set down for oral arguments on Oct. 26, 1962 (DRAFT)(3)—Parsons, J. E

Mld. Ntes 8-1-62. R

8/ 3/62 Plaintiffs brief in support of mo for sum judgmt due Aug. 20, 1962; defts brief in opposition and in support of cross mo for sum judgmt due Sept. 10, 1962; pltffs reply brief and brief in opposition to defts cross motion for sum judgmt due Sept. 20, 1962 defts reply to plaintiffs brief in opposition to cross motion for sum judgment due Sept. 30, 1962. Oral arguments reset from Oct. 26 to Nov. 2, 1962 at 2:00 PM—Parsons, J. E

Mld. Ntes. 8-6-62. D

8/20/62 Fld. Brief in support of pltff's mo. for Summary judgment.

9/11/62 Filed Brief for deft. wek

9/18/62 Due date for pltffs reply brief and brief in opposition to defts cross motion for summary judgment ext to Oct 1, 1962; due date for defts reply to pltffs brief in opposition to cross motion

for summ judgment ext to Oct 11, 1962—Parsons, J. E

Mld Ntcs 9-20-62.

10/ 1/62 Filed Plaintiffs Reply to Brief for the deft on cross motions for summary judgment. (153) E

10/ 8/62 Enter order to extend time for filing government's reply brief to and including Oct 22, 1962 by agreement. Parsons, J. E

Mld Ntcs. 10-8-62. mam

10/22/62 Filed Reply Brief for the deft. E

(Delvd to Judge Parsons Drawer). E

11/ 2/62 Enter order oral arguments on motion for summary judgment contd to Dec. 7, 1962 at 2:00 P.M.—Parsons, J. E

Mld. Ntcs. 11--5-62. mam

11/16/62 Enter order reset date for oral argument from Dec. 7, 1962 to Dec. 17, 1962 at 2:00 P.M. Parsons, J. E.

Mld. Ntcs. 11-19-62. mam

12/17/62 Enter order—oral arguments on motion for summary judgment contd to Jan. 18, 1963 at 2:00 P.M.—Parsons, J. E

Mld. Ntcs. 12-19-62. mam

1/14/63 On courts own motion order cs set for ruling on motions for summary judgment on Feb 1, 1963 at 2:00 P.M.—Parsons, J. E

Mld. Ntcs. 1-15-63. mam

1/30/63 On court's own motion date of Feb. 1, 1963 set for ruling on motions for summary judgment vacated. Copy of court's ruling will be forwarded to parties by mail. Parsons, J. t

Mld ntcs. 1/31/63. m

3/29/63 In accord with memorandum opinion to be filed hereafter and to be forwarded to parties, motion of deft U.S.A. for summary judgment is allowed and motion of pltff Allstate Ins Co for summary judgment is denied—Parsons, J. E

Mld. Ntcs. 4-1-63. (DRAFT) (7) JS-6 m

5/17/63 Filed Motion to correct apparent typographical error in memorandum opinion and order.

5/17/63 On motion of parties it is ord that all references to Sec. 24.12 of Treasury Regulations 129 contained in the court's memorandum opinion and order dated March 29, 1963 shall be and are hereby changed to Sec. 24.14 of Treasury Regulations 129. Parsons, J. (DRAFT) E

Mld. Ntcs. 5/20/63. m

5/24/63 Filed plaintiff's notice of appeal. $5.00 pd

5/24/63 Filed stipulation dispensing with bond on appeal.

5/24/63 Mailed copy of notice of appeal to U.S. Atty. J. P. O'Brien. G

5/29/63 Enter order amending court's written opinion dated March 29, 1963 to correct citation of Kaiser v. U.S.A. as 262 Fed. 2nd 367, and not as 252 Fed. 2nd 434. Parsons, J. t

Mld ntcs 5/31/63. m

6/27/63 Filed stipulation re extending appeal.

Order extending time for filing record on appeal and docketing the appeal by 2 weeks, from July 3 to July 17, 1963 on stipulation. Draft. Parsons, J.

Mailed notice 7/1/63. G

DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGMENT

(Caption and Formal Parts Omitted)

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, the defendant, the United States of America, hereby cross-moves this Court to enter summary judgment in its favor dismissing plaintiff's complaint with prejudice.

The grounds for this motion are that the pleadings of the parties, the stipulation of the parties, the attached affidavit of Harold T. Swartz, and certain statements in the affidavit of M. A. Poss attached to plaintiff's motion show that there is no genuine issue as to the material facts of this case, and that the defendant is entitled to judgment as a matter of law.

James P. O'Brien
United States Attorney

AFFIDAVIT

(Caption and Formal Parts Omitted)

The undersigned, Harold T. Swartz, being duly sworn, states as follows:

1. That he is an Assistant Commissioner of Internal Revenue in charge of the Office of Assistant Commissioner (Technical), and that by virtue of his office he has in his custody the files of the Internal Revenue Service indicating administrative practice as carried out by the national office of the Internal Revenue Service in administering the revenue laws.

2. That, based upon an inspection of these files, to the best of his knowledge and belief, it has been the administrative practice of the Internal Revenue Service since at

least 1945 to permit an insurance company subsidiary to conform its accounting period to a parent on fiscal year accounting period for the purposes of filing a consolidated return.

3. That the mechanics of how this has been typically allowed was, generally, as follows: A consolidated return including the income of both the parent and the subsidiary insurance company for the parent's normal fiscal year would be allowed, provided that the parent changed to a calendar year basis for the immediately following year. The subsidiary insurance company would be required to file a short taxable period return for the part of its prior calendar year up to the start of the parent's fiscal year. A short taxable period consolidated return would then be filed for the remaining part of this following calendar year.

4. That, to the best of his knowledge and belief, based upon an inspection of the files in the custody of his office, this administrative practice of allowing the conforming of a subsidiary insurance company's accounting period to the fiscal period of its parent for consolidated returns purposes in the maner outlined above has been followed consistently since at least 1945.

/s/ *Harold T. Swartz*
Harold T. Swartz
Assistant Commissioner of
Internal Revenue

Sworn to and subscribed before me, this 22nd day of September, 1961.

/s/ *Nina B. Baber*
Notary Public

My Commission expires
3-31-66.

PLAINTIFF'S MOTION FOR PRODUCTION OF DOCUMENTS

(Caption and Formal Parts Omitted)

Pursuant to Rule 34 of the Federal Rules of Civil Procedure, plaintiff hereby moves this Court to order defendant to produce and permit the inspection and copying of the following designated documents:

1. Memorandum dated October 30, 1946 from the Deputy Commissioner of the Income Tax Unit of the Bureau of Internal Revenue to the Chief Counsel of the Bureau of Internal Revenue, described at page 118 of the transcript of the deposition of Assistant Commissioner of Internal Revenue Harold T. Swartz, taken on December 19, 1961.

2. Any files which may be located in the office of the Chief Counsel of the Internal Revenue Service pertaining to the ruling letters which appear as Defendant's Exhibits 1 through 7, so marked for identification during the taking of the deposition of Assistant Commissioner Swartz.

3. The GCM written by the office of the Chief Counsel of the Internal Revenue Service to the Chief of the Bulletin Branch of the Internal Revenue Service sometime in 1956 or early 1957, described at pages 151-153 of the transcript of the deposition of Assistant Commissioner Swartz.

4. The letter written by the Tax Rulings Division of the Internal Revenue Service in Washington to the District Director of Internal Revenue at Chicago in reply to a request for technical advice in connection with plaintiff's case, described at pages 162-165 of the transcript of the deposition of Assistant Commissioner Swartz.

If defendant so requests, plaintiff has no objection to an order requiring the production of copies of these documents in which the names of the taxpayers involved are obliterated or excised.

The grounds for this motion are as follows:

Defendant has asserted the existence of an administrative practice within the Internal Revenue Service under which plaintiff and its parent, Sears, Roebuck and Company, would have been granted permission to file a consolidated tax return for the fiscal year ending January 31, 1951 if they had applied to the Commissioner of Internal Revenue for permission to do so.

In an attempt to prove the existence of such a practice, defendant took the deposition of Assistant Commissioner of Internal Revenue Harold T. Swartz on December 19, 1961. During the course of that deposition, copies of seven ruling letters to individual taxpayers from 1944 through 1956, found in the files of the Assistant Commissioner of Internal Revenue for technical matters, were marked for identification and Assistant Commissioner Swartz testified that these letters proved the existence of the asserted practice. Obviously, the circumstances under which these rulings were issued, including the reasoning of the responsible personnel in the Internal Revenue Service in issuing these letters, is highly relevant in determining the existence of the practice and, particularly, whether it was consistently followed and whether it would have been followed if Allstate and Sears had applied for permission to file a consolidated tax return for the fiscal year ended January 31, 1951. While Assistant Commissioner Swartz described, in a general way, the contents of the files relating to the ruling letters, the designated documents were not made available to plaintiff. These documents are highly relevant for the following reasons:

1. *The October 30, 1946 Memorandum from the Deputy Commissioner of the Income Tax Unit of the Bureau of Internal Revenue to the Chief Counsel of the Bureau of Internal Revenue.* On October 10, 1946, the Deputy Commissioner of Internal Revenue issued a ruling letter to the affiliated group of taxpayers involved denying permission to the affiliated group to file a consolidated return for the fiscal year ended September 30, 1946. (Def's. Ex. 4-B.) On October 15, 1946, the affiliated group requested reconsideration of its request for permission to file a consolidated tax return for that fiscal year. (Def's. Ex. 4-C.) On February 5, 1947, the Deputy Commissioner issued a ruling to the affiliated group granting permission to file a consolidated return for the fiscal year ended September 30, 1946. (Def's Ex. 4.) Assistant Commissioner Swartz testified that, before this ruling was issued, it was submitted by the Deputy Commissioner to the Chief Counsel for interpretation and review because a strict interpretation of the regulations would have led to denial of the right to file a consolidated return for that period and the Deputy Commissioner wanted to see whether the Chief Counsel agreed, legally, with the administrative position proposed to be taken by the Deputy Commissioner. (Tr. 120-121.) The Deputy Commissioner's memorandum to the Chief Counsel, described by Assistant Commissioner Swartz at page 118 of the transcript of his deposition, production of which is sought by plaintiff, is obviously relevant because it may disclose why the Deputy Commissioner adopted the position he did in the February 5, 1947 ruling. It should be noted that Assistant Commissioner Swartz summarized the contents of the Deputy Commissioner's October 30, 1946 memorandum to the Chief Counsel during the course of his deposition (Tr. 119, 121) and there is no good reason why plaintiff should not be allowed to see the document itself, rather than accept his summary thereof.

2. *Files from the Office of the Chief Counsel of the Internal Revenue Service Pertaining to the Seven Ruling Letters.* It appears that the ruling letters which were marked as Defendant's Exhibits 1, 2, and 4 of Assistant Commissioner Swartz' deposition were submitted to the Chief Counsel of the Bureau of Internal Revenue for review and approval before they were issued. (Swartz Dep., Tr. 186-187.) This indicates that there may be files within the office of the Chief Counsel which will shed light on the reasons for the issuance of the rulings alleged to constitute an administrative practice and yet no effort was made by Assistant Commissioner Swartz to examine the files of the Chief Counsel's office. (He even admitted that there may be pertinent files in the Chief Counsel's office.) (Tr. 96-99.) Furthermore, during the course of the deposition, Swartz was asked whether his office contained any files relating to one of the ruling letters (Def's. Ex. 2), other than the file then in Swartz' hands, and one of Swartz' aides, Mr. Levine, motioned to a file which was in front of him and counsel for defendant indicated that there were other pertinent files, though not in the "custody" of the Assistant Commissioner. (Tr. 96-97.) Since the Commissioner's office referred at least three of the seven proposed rulings to the Chief Counsel for review and approval, and since it is apparent that the Chief Counsel's office contains files which may shed light on the reasons for the issuance of the ruling letters, production of the Chief Counsel's files is imperative before this Court can be asked to pass on the existence of the asserted administrative practice.

3. *The GCM Written by the Office of the Chief Counsel of the Internal Revenue Service to the Chief of the Bulletin Branch of the Internal Revenue Service Sometime in 1956 or Early 1957.* The ruling letter which appears as Defendant's Exhibit 7 for identification was pro-

posed for publication, but publication was scotched by the office of the Chief Counsel in a memorandum to the Chief of the Bulletin Branch which stated, *in part,* that the "proper solution to the problem presented should be effected in amendment to the consolidated regulations." (Tr. 151-152.) One of plaintiff's main arguments in connection with the motion to strike Assistant Commissioner Swartz' affidavit was that the privilege to file a consolidated return could be granted only by a published regulation, not by anything less, such as a published or an unpublished ruling. The extract from the Chief Counsel's memorandum squelching publication of Defendant's Exhibit 7 indicates that the Chief Counsel agreed with plaintiff's position and plaintiff is entitled to see the entire text and reasoning of the Chief Counsel's GCM, which is obviously highly relevant and may constitute an admission against interest.

4. *The Letter Written by the Tax Rulings Division of the Internal Revenue Service in Washington to the District Director of Internal Revenue at Chicago in Reply to a Request for Technical Advice in Connection with Plaintiff's Case.* During the course of Swartz' deposition, it was revealed that at some time the office of the District Director at Chicago submitted a request for technical advice to the national office in connection with plaintiff's case and that the national office responded, discussing the question of whether and under what circumstances a fiscal year parent and a calendar year subsidiary insurance company may file consolidated returns. It also was shown that answers to requests for technical advice are handled in exactly the same manner as taxpayers' requests for ruling. (Tr. 162, 165-169.) Indeed, one of the documents relied upon by defendant to prove the existence of the administrative practice is not a ruling letter to an individual taxpayer, but an answer to a request for technical advice. (Def's. Ex. 1.) Obviously, the discussion of the privilege to file consolidated returns contained in the answer to the request for technical advice in plaintiff's case is as relevant (indeed, more relevant) as Defendant's Exhibit 1 or the private letter rulings (Def's. Exs. 2-7) in determining the policy of the Internal Revenue Service with respect to this question. Furthermore, it may contain important admissions against interest.

Therefore, for good cause shown, plaintiff is entitled to inspect and copy the designated documents.

/s/ *Charles W. Davis*
Charles W. Davis

/s/ *Edward W. Rothe*
Edward W. Rothe
Attorneys for Plaintiff
One North La Salle Street
Chicago 2, Illinois
Telephone: FInancial 6-3900

Of Counsel
William A. McClintock, Jr., Esq.
Hopkins, Sutter, Owen, Mulroy & Wentz

MEMORANDUM OPINION AND ORDER

This is an action by Allstate Insurance Company to recover income taxes and interest totaling $3,445,257.68 which were allegedly erroneously assessed and collected by the United States of America from Allstate for the years 1950-1953. The dispute in this case is whether or not Allstate is entitled to determine its Korean War excess profits tax credits for the years 1950-1953 by computing its average base period net income according to the alternative growth method prescribed in Subsection 435(e), which was added to the Internal Revenue Code of 1939 on January 3, 1951.

In accordance with the understanding of the parties and the Court, this cause presents at this time for the Court's determination the issue of whether or not the deposition of Harold T. Swartz, who is the Assistant Commissioner of Internal Revenue in charge of Technical Functions, and the letter rulings are competent and relevant to prove the existence of an unpublished administrative practice whereby insurance companies, regardless of apparent conflicting provisions in the law, would be allowed to file consolidated returns with parent corporations.

It has been said that relevancy is the tendency of evidence, being of probative worth, to establish a proposition which it is offered to prove. *Texas and Pacific Railway Company* v. *Coutourie,* 135 Fed. 465, 469. But how strong must this tendency be? Perhaps the test is whether or not the evidence offered renders the desired influence more probable than it would be without the evidence. *Mutual Life Insurance Company* v. *Hillmon,* 145 U.S. 285, 295.

In applying this test to the present issue, and after carefully examining and digesting all of the briefs and pleadings on file, in addition to the oral arguments heard in open court, it is determined that the Swartz deposition and the letter rulings do tend to establish the proposition which they are offered to prove, namely, the existence of an unpublished administrative practice. It is also determined that the evidence renders the desired influence more probable than it would be without the evidence. It is further determined that the Swartz deposition was rendered by an individual legally qualified and that all of the tendered evidence is competent. The Court thus concludes that the Swartz deposition and the letter rulings are both relevant and competent. Accordingly, Allstate's objections to the admission of the Swartz deposition and the letter rulings into evidence are overruled.

The Court is not determining at this time, however, the character and nature of the administrative practice which defendant has thus far proven or whether or not as such it has attained the status of law. Nor is this Court deciding that defendant has proven by a preponderance of the evidence that an administrative practice existed which allowed insurance companies, under the circumstances of this case, to file consolidated returns with parent corporations. That is to say, this Court in no way intends at this time to indicate that the tendered evidence, though relevant and competent for the purpose of proving an administrative practice, establishes either as a matter of fact or as a matter of law that if Sears and Allstate had wished to file consolidated returns they would have been granted permission to do so. In addition, this Court is not deciding whether the unpublished administrative practice as proven is relevant to prove the existence of a "privilege" to file a consolidated return for Allstate's first taxable year ending after June 30, 1950, within the meaning of Section 435(e)(1)(A)(i). These matters can intelligently be dealt with only after a full hearing on the merits of this cause. Whether or not the administrative practice will be relevant to the issue of "privilege" depends upon the construction placed upon that term.

Accordingly, trial briefs will be filed by the parties on the merits of the case and this cause is set down for oral arguments on October 26, 1962.

Enter:

/s/ James B. Parsons

United States District Judge

Date: July 31, 1962

MEMORANDUM OPINION AND ORDER

The parties have filed cross motions for summary judgment. Having discovered no genuine issue as to any material fact, I find that it is now proper to dispose of these motions. The undisputed facts, insofar as they are pertinent hereto, may be recited briefly as follows:

Plaintiff is a corporation organized under the laws of the State of Illinois and has its principal place of business at Skokie, Illinois. It has engaged in the business of underwriting and issuing various types of insurance policies, and during the years here in controversy it was subject to Federal income taxation under the provisions of Section 204 of the Internal Revenue Code of 1939.

All of the capital stock of Allstate is, and always has been, owned by Sears, Roebuck and Company. Sears is engaged in the business of selling all types of merchandise at the retail level. At all times here pertinent, Sears employed a fiscal year accounting period ending January 31, while Allstate employed a calendar year accounting period.

Due to the Korean War, an Excess Profits Tax Act was enacted on January 31, 1951, with retroactive effect to July 1, 1950, the purpose of which was to tax corporate profits attributable to wartime activity. At the same time, the Act provided for a number of special credits, including: (1) The credit based on invested capital (Section 436); (2) The credit based on general average earnings (Section 435[d]); and (3) The growth credit (Section 435[e]).

During the years 1950 through 1953, Allstate was required by the Internal Revenue Department to compute its excess profits tax credit according to the "general average of earnings" method. Allstate is of the opinion, however, that it should have been allowed to compute its

excess profits tax credit according to the "growth" method. Accordingly, Allstate here seeks to recover the alleged overpayment of excess profits taxes for the years 1950, 1952, and 1953 in the amount of $3,445,257.68, together with the statutory six per cent interest.

Section 435[e] [1] of the Internal Revenue Code of 1939, which sets forth the "growth" method, provides:

> "A taxpayer shall be entitled to the benefits of this subsection if the taxpayer commenced business before the end of its base period, and if * * * (A)(i) the total assets of the taxpayer as of the first day of its base period (when added to the total assets for such day of all corporations with which the taxpayer has the privilege under section 141 of filing a consolidated return for its first taxable year under this subchapter), determined under paragraph (3), did not exceed $20,000,000, and (ii) the total payroll of the taxpayer (as determined under paragraph (4)) for the last half of its base period is 130 per centum or more of its total payroll for the first half of its base period, or the gross receipts of the taxpayer (as determined under paragraph (5)) for the last half of its base period is 150 per centum or more of its gross receipts for the first half of its base period: * * *"

It is undisputed that Allstate met both the total payroll and gross receipts conditions. Is is also undisputed that Allstate commenced business before the end of its base period. What is in dispute, however, is the assertion by Allstate that its total assets, as determined by section 435(e)(1)(A)(i), did not exceed $20,000,000, the asset ceiling limitation placed by Congress upon the use of "growth" method. In determining Allstate's total assets one must add to Allstate's assets (which as of January 1, 1946, were $15,381,893.70) the assets of all corporations

with which the taxpayer had the "privilege" under Section 141" of filing a consolidated return during the years in question.

Thus, if Allstate *did not* have the privilege of filing a consolidated return with Sears, then Allstate would qualify for using the growth method since its total assets would not have exceeded $20,000,000. If, on the other hand, Allstate *did* have the privilege of filing a consolidated return with Sears, then Allstate would *not* qualify for using the "growth" method since its total assets would have exceeded $20,000,000.

The legal issue, as stated by plaintiff, with which I am thus confronted is whether or not Allstate, which had sufficient increases in both payroll and gross receipts during its base period to qualify for the use of the alternative growth method of computing average base period net income for excess profits tax credit purposes, under Section 435(e)(1)(A) of the Internal Revenue Code of 1939, is precluded from using that method because its own January 1, 1946, assets, which were less than $20,000,000, must be aggregated with those of its parent, Sears, Roebuck and Company, in determining compliance with the $20,000,000 maximum asset limitation on the use of the growth formula contained in Section 435(e)(1)(A)(i) of the 1939 Code, for the reason that Allstate had the privilege of filing a consolidated return with Sears for its first taxable year ending June 30, 1950. The controversy thus hinges entirely upon the legal issue of whether or not Allstate and Sears had the *"privilege under Section 141"* of the 1939 Code of filing consolidated returns.

As the parties well realize, the proper way to deal with this problem is to examine carefully the language of the pertinent statutes. Section 435(e)(1)(A)(i) contains the phrase "privilege under section 141." Thus, if Allstate had *"the privilege under section 141"*, of filing a consolidated return with Sears, Allstate would not have been entitled to use the "growth" formula.

We are therefore led to Section 141 which explains when a corporation has such a privilege. Section 141(a) provides that "[a]n affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return. . . ." Paragraphs (d) and (e) define what constitutes "an affiliated group" and it appears undisputed that Allstate and Sears constituted such a group.

It will be noted also that Paragraph (a) provides that affiliated groups *"shall"* have the privilege. It thus appears that it was the intention of Congress to give such groups an unqualified privilege to file consolidated returns. The phrase which presents difficulty, however, is "subject to the provisions of this section". Although this phrase perhaps is more directly related to those provisions defining an "affiliated group", nevertheless, one cannot escape the fact that it also relates to Paragraph (b).

Paragraph (b) provides:

> "The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability."

It is to be noted, however, that the Secretary is hereby empowered to prescribe *only* those regulations as he may deem necessary which relate to the "manner" of filing

consolidated returns. Section (b) presumes the fact that affiliated corporations have filed consolidated returns and merely grants the Secretary authority to regulate the "manner" by which the tax liability of such affiliated corporations may be most properly "returned, determined, computed, assessed, collected, and adjusted", so as to effectuate the purposes of the Act. Although counsel have done a magnificent job in briefing the exceedingly complex questions arising under their motions, and although I have never before been privileged to encounter such profound analyses and such superb argumentation as I have encountered in this cause, nevertheless, for some reason little consideration has been given to the meaning and effect of Paragraph (b) of Section 141.

It appears to me that a clear reading of Paragraph (a) of Section 141 reveals that it was Congress' definite intention to confer upon affiliated corporations such as Allstate and Sears the privilege of making consolidated returns. Insofar as the "subject to" clause relates to Paragraph (b), it was the intention of Congress to permit the Secretary to regulate the "manner" in which the privilege was to be exercised. Congress authorized the Secretary only to prescribe the "manner" (once the privilege granted by Paragraph (a) was utilized) in which the tax liability of such affiliated corporations could most properly be returned, determined, computed, assessed, collected, and adjusted. I find no language in Paragraph (b) which authorizes the Secretary to revoke or deny the privilege so affirmatively granted in Paragraph (a).

With this in mind, we may proceed to examine the pertinent regulations which plaintiff contends denied it the privilege of filing consolidated returns with Sears.

Pursuant to Paragraph (b) of Section 141, the Secretary had promulgated Section 24.14 of Treasury Regulations 129, which requires subsidiaries, such as Allstate, to

adopt the accounting period of the parent, such as Sears, (which in this case would be a fiscal year period) if it wished to file a consolidated return. Standing alone, this regulation appears valid. A problem arises, however, when considering Section 29.204-1 of Treasury Regulations 111 in light of Section 24.14, for the former regulation requires insurance companies such as Allstate to follow a calendar year accounting method. This regulation too, by itself, appears valid. Yet, the *effect* of the two regulations is to deny Allstate the privilege of filing consolidated returns, something which is quite contrary to the provisions of Paragraph (a) of Section 141.

It is thus very clear that *under the regulations* Allstate and Sears did not have the "privilege" of filing consolidated returns. Nor did Allstate have the "option", as defendant contends, to file such returns under the regulations. See *Words and Phrases,* Vols. 30, 33, and 37A for definitions of words "right", "privilege", and "option". Furthermore, it is clear that the unpublished administrative practice, the proof of which has occupied so much of counsels' time and effort, did not "re-confer" upon Allstate and Sears the privilege which the regulations purportedly took away. Such unpublished rulings do not have the effect of law and I find it unreasonable to contend that such rulings, private in nature, and subject to the Commissioner's discretion insofar as precedent value is concerned, constituted a privilege. *Bartels* v. *Birmingham,* 332 U.S. 126; *Oberwinder* v. *C.I.R.,* 147 F.2d 255; *Kaiser* v. *United States,* 262 F.2d 367; *Pomeroy Coop. Grain Co.* v. *C.I.R.,* 288 F.2d 326; *Weller* v. *C.I.R.,* 270 F.2d 294. The practice proven merely indicates what the Commissioner had done in like situations and it merely illustrates the fact that Allstate had the "opportunity" (if it was in fact aware of such "opportunity") to "ask" the Commissioner to grant it a special privilege to file consolidated

returns with Sears, regardless of the conflicting regulations.

Be that as it may, I am nevertheless of the opinion that Sears and Allstate under Section 141 did, in the years in question, have the privilege of filing consolidated returns, the regulations notwithstanding, and that Congress so intended them to have this privilege. I am also of the opinion that Section 24.14 of Treasury Regulations 129 was *null* and *void insofar as it applied to insurance subsidiaries whose parents did not file on a calendar year basis.* The effect of this regulation was to contradict the clear purpose of Paragraph (a) of Section 141 and to that extent it was invalid from its inception—and being invalid, it could not operate to defeat the privilege conferred by Section 141(a). Although the validity of Section 24.14 of Treasury Regulations 129 insofar as it applied to insurance subsidiaries has since been restored by virtue of Section 1.1502-14(c) of the regulations under the 1954 Code, added by T.D. 6412, approved September 9, 1959 (Cum. Bull. 199), since the latter has modified the effect of the former, nevertheless, it is the opinion of the Court that had Allstate and Sears attempted to file a consolidated return in the years in question any other court would likewise have held as I am now holding. It is well established that a Treasury regulation which exceeds the legislative intent of the Act which it purports to interpret for administrative purposes is of no effect. *C.I.R.* v. *Aluminum Company of America,* 142 F.2d 663; *Miller* v. *C.I.R.,* 327 F.2d 850; *Manley* v. *United States,* 83 F.Supp. 79. Insofar as provisions of Treasury regulations purport to establish a rule contrary to the construction of a section of the Internal Revenue Act, such provisions are unauthorized. *C.I.R.* v. *Kay Mfg. Corp.,* 122 F.2d 443; *Kaufman* v. *United States,* 131 F.2d 854. To the extent that a regulation de-

parts from and conflicts with the meaning and purpose of a statute it is to that extent unreasonable, unauthorized and invalid. *Trust of Bingham* v. *Commissioner,* 325 U.S. 365; *Manhattan General Equipment Co.* v. *Commissioner,* 297 U.S. 129; *Miller* v. *United States,* 294 U.S. 435. A Treasury regulation which operates to create a rule out of harmony with a statute is a nullity. *In re Town Crier Bottling Co.,* 123 F.Supp. 588; *C.I.R.* v. *Winslow,* 113 F.2d 418; *Granquist* v. *Hackleman,* 264 F.2d 9; *Boykin* v. *C.I.R.,* 260 F.2d 249; *Scofield* v. *Lewis,* 251 F.2d 123. A regulation cannot take away rights or privileges which Congress has given. *Russell Mfg. Co.* v. *United States,* 175 F.Supp. 159.

Accordingly, it is the opinion of the Court that defendant's motion for summary judgment should be, and the same hereby is, allowed, and that plaintiff's motion for summary judgment should be, and the same hereby is, denied.

Enter:

/s/ James B. Parsons
United States District Judge

Date: March 29, 1963

MOTION TO CORRECT APPARENT TYPOGRAPHICAL ERROR IN MEMORANDUM OPINION AND ORDER

(Filed May 17, 1963)

The parties, jointly, hereby move this Court to correct what appears to be a typographical error in this Court's Memorandum Opinion and Order dated March 29, 1963.

On pages 5 and 6 of the Memorandum Opinion and Order, the Court discusses the requirement in the Treasury Regulations that subsidiaries, such as Allstate, adopt the accounting period of the parent, such as Sears, if it wished to file a consolidated return, citing Section 24.12 of

Treasury Regulations 129. However, it is Section 24.14 of Treasury Regulations 129 which contains the requirement discussed by the Court.

In order to eliminate any possible confusion, the parties therefore request that the Court enter an order to the effect that all references to Section 24.12 of Treasury Regulations 129 in the March 29, 1963 Memorandum Opinion and Order be changed to Section 24.14 of Treasury Regulations 129.

/s/ *Edward W. Rothe*
Attorney for Plaintiff

/s/ *James P. O'Brien*
United States Attorney

Dated: May 17, 1963

ORDER CORRECTING TYPOGRAPHICAL ERROR IN MEMORANDUM OPINION AND ORDER DATED MARCH 29, 1963

Pursuant to the joint motion of the parties, calling to the Court's attention a typographical error in the Memorandum Opinion and Order dated March 29, 1963, it is hereby ordered that all references to Section 24.12 of Treasury Regulations 129 contained in that Memorandum Opinion and Order shall be and are hereby changed to Section 24.14 of Treasury Regulations 129.

Enter:

/s/ *James B. Parsons*
United States District Judge

Dated: May 17, 1963

BRIEF FOR THE DEFENDANT IN OPPOSITION TO PLAINTIFF'S MOTION TO STRIKE AFFIDAVIT OF ASSISTANT COMMISSIONER SWARTZ

(Filed November 14, 1961)

This is an action brought by Allstate Insurance Company for the recovery of $3,445,257.67 in excess profits tax and assessed interest for the calendar years 1950, 1952 and 1953 which it alleges to have been erroneously assessed and collected by the defendant, plus statutory interest thereon.

QUESTION PRESENTED

Whether the affidavit of Assistant Commissioner Swartz with respect to an administrative practice of the Internal Revenue Service should be stricken from the record on the grounds that such a practice, is immaterial or irrelevant to the issues in this case.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and Regulations are set out in the Appendix, *infra*.

STATEMENT

On September 11, 1961, the taxpayer filed a motion for summary judgment in this case and on September 26, 1961, the Government filed a cross-motion for summary judgment, attaching the affidavit by Harold T. Swartz, Assistant Commissioner of Internal Revenue, which is at issue on this motion. The Assistant Commissioner's affidavit asserted (par. 1) that, by virtue of his office, he had custody of the files of the Internal Revenue Service indicating administrative practice as carried out by the national office of the Internal Revenue Service in administering the revenue laws and (par. 2) that "based upon an inspection of these files, to the best of his knowledge and belief"

a certain administrative practice of the Internal Revenue Service had been followed consistently since at least 1945. (The details of this administrative practice are set out in paragraphs 2 and 3 of the affidavit.) On October 13, 1961, the taxpayer filed a motion for a continuance of the summary judgment proceedings for the purpose of taking the deposition of Assistant Commissioner Swartz. The Court held hearings on this motion on October 17, and on October 23, 1961. During the course of oral argument on October 17, Government counsel informed the Court and taxpayer's counsel that Mr. Swartz' affidavit was based upon five letter rulings issued to individual taxpayers, and the Government's counsel offered to make copies of these rulings available to taxpayer's counsel, at the Court's suggestion, in order to obviate the necessity of taking Mr. Swartz' deposition.[1]

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[1] Since Mr. Swartz' affidavit was based on these letter rulings which had been issued, and because the rulings can speak for themselves, it is the Government's view that a deposition of Mr. Swartz is unnecessary and could develop no other relevant *factual* material. Although this question has been held in abeyance by the Court pending decision of the question as to whether evidence of this unpublished administrative practice is admissible, the taxpayer has seen fit in its brief to argue for reasons why a deposition is still necessary. (Br. 6, fn. 2.) The reasons asserted are without merit. As for the question as to whether Mr. Swartz' affidavit correctly states the substance of the rulings, the Government offered to submit copies of the rulings as part of the stipulation filed November 6, 1961, so that the Court itself could decide this question. Taxpayer refused to agree to this solution. As to the question of whether these "constitute" an administrative practice, and further questions as to the "origin, rationale, availability, scope and consistency, etc.," these seem more questions for the Court, and quibbling over what the words "administrative practice" mean, than relevant factual matter for which a deposition is necessary. Of course, attempts to attack the legal basis of this practice by questioning of Mr. Swartz are obviously improper. With these comments on taxpayer's assertions set out, the Government will leave the matter to resolution at the proper time.

It was the Government counsel's understanding of the Court's purpose on the hearing of October 17 that taxpayer's counsel could examine the five letter rulings tendered to determine whether there was further reason or necessity for taking Mr. Swartz' deposition, and that taxpayer's counsel would advise the Court thereon at the hearing on October 23 and show the Court why a deposition would be needed despite the tendering of the rulings. The Government's counsel also informed the Court and taxpayer's counsel that these five letter rulings tendered were the only letter rulings in this area which had been located in the files, and offered to provide a further affidavit of Mr. Swartz to that effect.

At the hearing on October 23, taxpayer's counsel shifted his ground and presented the Court with an oral motion to strike the affidavit (under Rule 56(e) of the Federal Rules of Civil Procedure) on the grounds that the matter set out therein was irrelevant and inadmissible in evidence. Taxpayer's counsel suggested that a stipulation be filed as to the basis for Mr. Swartz' affidavit, i.e., the five letter rulings previously mentioned, the fact that these letter rulings had not been published, and that these five letter rulings represented all the requests for rulings by taxpayers since 1945 along similar lines or involving essentially the same issue. A stipulation substantially in this form was filed on November 6, 1961.[2]

The question, then, for the Court's decision is whether this affidavit of Assistant Commissioner Swartz with re-

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[2] A further search of the files of the office of Assistant Commissioner (Technical) after the hearing of October 23, in order to verify the proposed stipulation disclosed an additional ruling dated August 21, 1951, and this fact has been incorporated in paragraph 3 of the stipulation filed. A copy of this ruling has been furnished by the Government to taxpayer's counsel. No other rulings or requests for rulings since 1945 have been located.

spect to an administrative practice of the Internal Revenue Service, reflected in unpublished letter rulings to individual taxpayers, is irrelevant to the issue in this case. In order to understand this question, it is necessary to understand the issue presented by the controversy on the merits. Consequently, the Government will briefly summarize its view of the case.

The only issue to be decided in this case is whether Allstate Insurance Company, the taxpayer, was entitled to compute its excess profits credit for the taxable years 1950 through 1953, inclusive, under the so-called "growth" method prescribed in Section 435(e) of the Internal Revenue Code of 1939. If it is entitled to use this "growth" method for the computation of its excess profits credit, then the taxpayer is entitled to a refund, but if it is not and must instead use the usual "average income" method prescribed in Section 435(d), then the Commissioner's deficiency assessment was properly made, and no refund is due to the taxpayer. The point of dispute between the Government and the taxpayer with respect to the taxpayer's qualifications for the special "growth" method prescribed by Section 435(e) concerns the "total asset" test set out in Section 435(e)(1)(A)(i). The total asset test for the special "growth" method for the computation of the excess profits credit requires that the total assets of the taxpayer, as carefully defined in Section 435(e)(3), "as of the first day of its base period [3] (when added to the total assets for such day of all corporations with which the taxpayer has the privilege under section 141 of filing a consolidated return for its first taxable year under this subchapter [4])", not exceed $20,000,000. It is stipulated

[3] Since 1946 is the first base period year, the "first day of its base period" would be the first day of its 1946 year.

[4] The first taxable year ending after June 30, 1950.

that if the total assets of Allstate were added to those of its parent, Sears Roebuck & Company, on the applicable date, they would exceed $20,000,000. (See stipulation filed October 9, 1961.) The question on the merits in this case, then, is whether Allstate's assets should be combined with Sears for purposes of this "total assets" test, the Government maintaining that they should be so combined, and taxpayer maintaining that they should not be and that therefore it meets the test and qualifies for the "growth" method credit.

The statutory language of the "total assets" test requires the combination of the taxpayer's assets with those "of all corporations with which the taxpayer has the privilege under section 141 of filing a consolidated return" for its first taxable year ending after June 30, 1950. It is the Government's primary position in this case that Congress, in using this language, actually intended to combine with the taxpayer's assets the assets of members of an "affiliated group" as defined in Section 141 and it is undisputed that Allstate and Sears qualified as an "affiliated group" at the applicable time. It is however taxpayer's view that the language in Section 435(e)(1)(A)(i) must be construed literally, and that Allstate must have had an actual "privilege" [5] of filing a consolidated return with Sears for its first taxable year ending after June 30, 1950, before its assets should be combined with those of Sears

[5] How the taxpayer interprets the word "privilege" is also somewhat in dispute. Assuming *arguendo* that the Court adopts taxpayer's approach to the total assets test, does the word "privilege" mean an absolute right to file a consolidated return exercisable in any event, or does it mean that taxpayer would have been allowed the special "privilege" of filing after complying with certain requirements, such as receiving permission for an accounting period change from the Commissioner?

for purposes of the total asset test. It is in connection with taxpayer's own theory of the statute, not the Government's, that Mr. Swartz' assertion of an administrative practice becomes, in the Government's view, highly relevant. Thus, to spell out the Government's position still further, it believes that the statutory "total asset" test in the language in Section 435(e)(1)(A)(i) refers to the concept of an "affiliated group", and there is no dispute that, if the Government is correct in this basic position, Allstate does not qualify for the "growth" method. If, of course, taxpayer is now willing to agree that the Government's view of the statute is the correct one, then Mr. Swartz' affidavit and the administrative practice is irrelevant. However, if the Court should adopt the taxpayer's view that the total asset test refers to Allstate's "privilege" of filing a consolidated return with Sears, had they chosen to do so,[6] the Court will then have to decide whether it had such a "privilege", and in such a decision, the matters set out in Mr. Swartz' affidavit become relevant.

Assuming, then, for the purposes of argument on this motion, that the total asset test refers to an actual "privilege" to file a consolidated return on the part of Allstate, it is necessary to analyze in some detail where Mr. Swartz' assertion of an administrative practice fits into the problem. According to taxpayer's argument, the obstacle preventing Allstate from filing a consolidated return with Sears for its first taxable year after June 30, 1950, is the fact that Allstate was on a calendar year accounting period, whereas Sears was on a fiscal year accounting period ending January 31. Section 141(a) of the 1939 Code, which is the Congressional grant of the "privilege to file consolidated returns", provides that an affiliated group (as defined in Section 141(d)), shall have the "privilege" of making a consolidated return, that the making of a consolidated return shall be upon the condition that the members of the affiliated group consent to all of the consolidated return Regulations,[7] and that the making of a consolidated return is considered such a consent.

The Commissioner's applicable consolidated return Regulations provided that subsidiary corporations had to adopt an annual accounting period in conformity with the common parent in order for the affiliated group to file a consolidated return. (Treasury Regulations 129, Section 24.14.) If the taxpayer Allstate was to file a consolidated return with its parent Sears, their accounting periods would consequently have to be conformed. As pointed out above, conforming the accounting periods was the only obstacle, *if it was an obstacle*, to the filing of a consolidated return by this taxpayer.

It is essentially the taxpayer's argument that these accounting periods could not be conformed for the first taxable year after June 30, 1950, because of the provisions of Treasury Regulations 111, Section 29.204-1, that insurance companies taxable under Section 204 of the 1939 Code

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[6] While at points in its brief (e.g., p. 34) taxpayer seeks to treat the question as whether Allstate and Sears could be compelled to file a consolidated return, we are sure that taxpayer recognizes that the question even on its theory is not whether they could be forced to file such a return but whether, had they seen fit to do so, they would have been permitted to do so.

[7] These Regulations are prescribed under the authority of subsection 141(b). Treasury Regulations 129 are applicable to taxable years ending after December 31, 1949, and are therefore the applicable consolidated return Regulations here. See Treasury Regulations 111, Section 29.141-1(a), and Treasury Regulations 129, Section 24.0(a). Congress conferred broad discretion on the Commissioner in the issuance of these consolidated return Regulations. See *Charles Ilfield Co.* v. *Hernandez*, 292 U.S. 62, 65.

(as Allstate was) were directed to file their returns "on the basis of the calendar year." (See Br. 12-13.) There was thus an apparent conflict or inconsistency between the Commissioner's consolidated return Regulations with respect to the accounting periods of the affiliated group (which provided that the subsidiary would adopt the parent's accounting period, Treasury Regulations 129, Section 24.14(a)) and the Commissioner's regulation with respect to certain insurance companies (that they should use the calendar year accouuting period, Treasury Regulations 111, Section 29.204-1). The Commissioner, in his consolidated return Regulations with respect to the accounting period for the affiliated group, had provided that (Treasury Regulations 129, Sec. 24.14(b)):

> If a change of accounting period is necessary in order to conform the accounting period of the common parent and of its subsidiary, and if the requirements of Section 29.46-1, Regulations 111 relating to notice of change, cannot otherwise be complied with, such notice shall be furnished at or before the time for filing the consolidated return.

Consequently, in his consolidated return Regulations, the Commissioner had specifically prescribed a method for conforming the accounting periods of subsidiaries to parents and for the notice requirements for such changes of accounting periods. Under this method as set out, Allstate could adopt Sears' fiscal year ending January 31, 1951, and could file a consolidated return for this fiscal year without securing advance permission from the Commissioner. It is essentially the taxpayer's position that this quoted provision had no application to it because of the insurance company regulation referred to above. It is in connection with this problem of conforming accounting periods that the affidavit of Mr. Swartz becomes significant.

ARGUMENT

I

ASSISTANT COMMISSIONER SWARTZ' AFFIDAVIT SETS FORTH FACTS PROPERLY ADMISSIBLE IN EVIDENCE

The affidavit in question states, on knowledge and belief, that an administrative practice existed, describes the administrative practice, and further states that it was consistently followed since at least 1945. When the affidavit is supplemented by the stipulation filed on November 6, 1961, the manner and occasions upon which the described administrative practice was followed and carried out are made clear. Although the taxpayer's counsel at the argument on October 23, 1961, urged that the affidavit should be stricken because the statements therein were conclusionary and interpretative, taxpayer apparently recognizes that this argument is without merit, since it only deigns to cover the matter in a footnote in its brief. (See Br. 19, fn. 5.) It appears clear that the existence of an administrative practice is a fact which can be presented by testimony and that consequently Mr. Swartz' affidavit states evidentiary facts. He stated these facts on knowledge and belief based on his examination of certain files of which he has custody by virtue of his office. However, taxpayer's counsel apparently having relinquished this initial argument, the Government will move on to taxpayer's primary contention for striking the affidavit, that is, that the existence of an unpublished administrative practice, if not promulgated by formal regulation, is irrelevant to the issues in this case.

A. *The taxpayer's lengthy analysis of the publication provisions of the Administrative Procedure Act and the Federal Register Act has nothing to do with the question presented here*

It is apparently taxpayer's argument that no "privilege" to file consolidated returns with Sears could exist

unless this privilege was granted by formally published Regulations, and that unpublished letter rulings to individual taxpayer evidencing the existence of an administrative practice cannot be used by the Government to show that such a "privilege" existed. This argument completely misconceives the purpose for which the Government offers this evidence with respect to an administrative practice.

The Government has no quarrel with the taxpayer's assertion that substantive rulings and Regulations, binding upon, and for the guidance of, the public must be promulgated and formally published in compliance with the rule-making procedure prescribed in Section 4 of the Administrative Procedure Act (Appendix, *infra*) and in the Federal Register Act. (Br. 22.) However, Section 4(a) of the Administrative Procedure Act exempts from the notice, hearing and publication requirements of the Act "interpretative rules", except where notice and hearing is required by statute. Taxpayer has pointed to no such special statute, and the Government does not know of any that is applicable. Rulings issued to individual taxpayers upon their request for information or for the Commissioner's position in respect to a particular transaction rather clearly fall within this "interpretative rules" exception. (See discussion in taxpayer's brief, pages 35-36.) The unpublished letter rulings issued to individual taxpayers are not intended for general guidance and are not binding on the public. They are merely answers to requests for advice dealing with the particular taxpayer in question. To hold, as taxpayer apparently urges, that the Internal Revenue Service need go through the involved hearing, notice and publication procedure prescribed by the Administrative Practice Act and the Federal Register Act every time it gives requested advice to an individual

taxpayer would paralyze the administration of the Internal Revenue laws and in all likelihood deprive taxpayers of the benefit of any such advice. Certainly taxpayer does not mean to argue that every individual ruling issued to a particular taxpayer must be processed through this hearing, notice and publication procedure. It is noted that similar interpretative rulings of the Service dealing with an alcohol labeling problem have been held to be exempt from the notice and hearing procedures of these Acts. See *Gibson Wine Co.* v. *Snyder*, 194 F. 2d 329 (C.A. D.C.). It is noted that the Regulations issued with respect to publication of Regulations, Treasury Decisions, and Rulings after enactment of the Administrative Procedure Act do not require that every private ruling be published, but only those which "announce a ruling or decision upon a novel question or upon a question in regard to which there exists no previously published ruling or decision, or for other reasons, are of such importance as to be of general interest." (26 C.F.R. (1949 ed), Sec. 601.118.) Similar language is contained in the front page of the Cumulative Bulletins. (Cf. Br. 37-38.) Thus, if the ruling in question is of no general interest or is of limited application, the Commissioner will not publish it.

As pointed out above, the Commissioner, by a formally adopted regulation, has provided that the conforming of accounting periods is a requirement for filing consolidated returns, and the regulation allows such filing if the subsidiary is a member of the affiliated group and can conform its accounting period to the parent. The promulgation of this regulation was pursuant to express authority granted by the statute. The taxpayer has not argued that this regulation is invalid, and this regulation grants the "privilege" in question upon conforming the accounting periods. Thus, the only issue is *how* and *if* this conform-

ing of accounting periods can be accomplished once a taxpayer qualifies as a member of an affiliated group. The Commissioner, in his consolidated return Regulations (Sec. 24.14, Appendix, *infra*) has outlined and established a method, and the problem in this case is only raised by an apparent conflict with another regulation directing an insurance company to file its returns on the calendar year basis, and thus (as taxpayer would have it), inferentially, prohibiting an insurance company's subsidiary from following the consolidated return Regulations method for conforming to its parent's fiscal year period.

In this situation, certain taxpayers requested advice from the Commissioner as to how to resolve this problem and they received advice. The advice they received from the Commissioner is reflected in these letter rulings referred to in the stipulation filed on November 6, 1961. The advice given to a particular taxpayer in the ruling letter of May 26, 1945, was distributed by the national office to the field offices of the Internal Revenue Service for their guidance. Thus, the Commissioner developed an administrative practice for the solving of this problem when taxpayers in this peculiar situation requested his advice as to the method to be used to conform accounting periods.

Is it the taxpayer's position that the Commissioner could not issue these letters of advice to individual taxpayers as to how he interpreted his own Regulations and as to the method he would allow for conforming accounting periods so that consolidated returns could be filed? The Government is not here urging that the Commissioner could bind taxpayers by such private letter rulings to a practice or procedure which was adopted without conformity to the procedures of the Administrative Procedure Act and the Federal Register Act. In other words, if the Commissioner had wished *to require* a taxpayer in this peculiar posi-

tion to resort to a particular procedure to conform accounting periods, *or bind* taxpayers to a particular interpretation of the statute, or issue a substantive ruling of general and binding effect, it would appear that he would have to go through the formal procedures required by the statutes. But to say that the Commissioner could not issue interpretative rulings to individual taxpayers, and develop a practice which he would follow through such a case by case handling of particular taxpayers' requests for advice is a denial of the very concept of an administrative procedure and is absurd.

Once we put to one side the taxpayer's argument, which no one here disputes, that an unpublished practice cannot be binding or enforced upon the taxpayer,[8] one sees that all of taxpayer's arguments based on the Administrative Procedure Act and the Federal Register Act are not applicable here. It is the Government's view that this administrative practice is relevant in order to show what the Commissioner would have done in the hypothetical situa-

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[8] It should be noted that the cases cited by the taxpayer all concern attempts by the Government to enforce a rule or regulation. Thus, *Tobin* v. *Edward S. Wagner Co.*, 187 F. 2d 977 (C.A. 2d), cited and discussed on page 25 of taxpayer's brief, involved a question of coverage under Regulations and was an attempt by the Government to enjoin the defendant under these Regulations. *Woods* v. *Benson Hotel Corp.*, 75 F. Supp. 743 (Minn.), affirmed, 168 F. 2d 694 (C.A. 8th), cited and discussed on pages 34-35, was also an attempt to enjoin on the basis of non-compliance with certain Regulations. *Hotch* v. *United States*, 212 F. 2d 280 (C.A. 9th), cited on page 35, was a *criminal* proceeding against a fisherman who disregarded a Regulation prohibiting fishing in a certain area. None of these cases purport to hold or even discuss a situation involving interpretative rulings without general or binding effect, and are of no aid to the taxpayer here.

tion which would have existed if Allstate had wished to file a consolidated return with its parent, Sears, and has asked the Commissioner for advice as to this problem or permission to go ahead in so filing.

Thus, the evidence with respect to this practice shows how the Commissioner had treated similar situations and further shows that the Commissioner had worked out a resolution of any possible conflict between his regulation with respect to the accounting period of an affiliated group and his regulation with respect to insurance companies filing returns on the calendar year accounting period. As pointed out by taxpayer (Br. 21-23), the Commissioner had broad discretion conferred upon him by Congress in the consolidated return area. Certainly the Commissioner was justified in finding a way in which consolidated returns could be filed, if desired, by insurance companies with non-insurance parents on fiscal years. Although a taxpayer was not bound to adopt or use the method for conforming accounting periods which the Commissioner developed as his administrative practice, and might have urged or requested some other method, the fact is (as the affidavit of Mr. Swartz shows) that the Commissioner had consistently sanctioned a particular method to particular taxpayers seeking his advice, *and that he was permitting the filing of consolidated returns through this method.* Accordingly, to briefly summarize, it is not the Government's purpose in offering Mr. Swartz' affidavit to urge that Allstate was bound by any such administrative practice or required to follow any such method. Rather, it is the Government's purpose to show that the Commissioner had developed a particular practice by which insurance companies could conform their accounting periods to their parent's and thus show that Allstate could have filed consolidated re-

turns with its parent, Sears, if it had wanted to (i.e., using the taxpayer's terminology, it had the "privilege" of filing a consolidated return with Sears).

It should be pointed out again that the total asset test set out in Section 435(e)(1)(A)(i) (Appendix A) (under taxpayer's theory) assumes a hypothetical situation, that is, that the assets of the taxpayer are to be combined with those of the corporations with which it could file consolidated returns *if it wanted to.* The question is not whether Allstate and Sears could be compelled to file a consolidated return or indeed whether they knew what their "privilege" was. If a consolidated return were actually filed, there would obviously be no problem. Of course, Allstate did not want to have so filed and would not have so filed because it would then have lost the argument it now makes for the growth method.

Accordingly, any attempt by taxpayer to argue that this administrative practice is illegal or in violation of the statute and Regulations is, at best, a difficult one in these circumstances. If the taxpayer, Allstate, had wanted to file a consolidated return and if it therefore had wanted to conform its accounting period to that of its parent, it presumably would have been willing to go through the procedure suggested by the Commissioner so that it could conform its accounting period and file a consolidated return with its parent, Sears. Once the accounting periods were conformed, it would, of course, have had the "privilege" of filing consolidated returns. Having wanted to so file and having filed with the Commissioner's advice, is it likely that it would have then argued that the procedure suggested was illegal? But whether it wished to argue about the method for conforming or not, it would have been allowed to file and hence had the "privilege".

II.

NO PRONOUNCEMENT BY THE INTERNAL REVENUE SERVICE REFERRED TO BY TAXPAYER MAKES THIS ADMINISTRATIVE PRACTICE IRRELEVANT

Taxpayer urges that certain pronouncements by the Internal Revenue Service in the Federal Register and in its Cumulative Bulletins prohibit the Government from proving the existence of this unpublished practice. It appears that taxpayer's argument is something akin to an estoppel argument. Typically an estoppel argument requires the proof that the other party relied on some representation to its detriment. Allstate has shown no such reliance here and could not, because the total assets test involves (as discussed above) a hypothetical situation. And the Government is not attempting to bind the taxpayer by this practice. The Government is simply pointing out that, if as taxpayer urges, the statutory question in this case is whether taxpayer could in fact have filed a consolidated return, then we know of no better proof than the fact that similarly situated companies who in fact tried to do so were permitted to do so.

A close study of the authorities cited fails to show that the Government is estopped from proving how the Internal Revenue Service handled certain situations by unpublished letter rulings giving advice to taxpayers. Of course, the Revenue Service publishes some rulings in its Cumulative Bulletins, but no published pronouncement of the Service states that all rulings must be published, or that unpublished rulings would have to be disregarded when the Service was confronted with a similar request for advice by a taxpayer. Any argument for such a position invites an inconsistent handling of such requests for advice, which is certainly an undesirable result.

It is true that the Cumulative Bulletins up until 1951[9] contained on the front or introductory page a statement that unpublished rulings or decisions would not be "cited or relied upon" by officers or employees of the Revenue Service as a precedent in the disposition of other cases. A study of the position of the pronouncement in the Federal Register, quoted on page 38 of taxpayer's brief in relation to the section headings, indicates that it may be concerned with a public statement by a Service employee to a taxpayer that "we have ruled or have done so and so" in a named case. Employees of the Internal Revenue Service were and are forbidden by law to disclose actions taken with respect to any particular taxpayer.[10] The Government has not violated this rule in this case. However, even in the face of this pronouncement of questionable applicability to the instant situation, it appears obvious that the Commissioner, being faced with a request for advice from a taxpayer, would and should refer to the advice he had given before in similar situations, whether the ruling that had been issued before was published or unpublished. Certainly the Commissioner should strive for consistent results to all taxpayers in similar circumstances. Not only is this true as a general proposition, but as the stipulation filed on November 6 indicates, the initial letter ruling dated May 26, 1945, was distributed by the national office to the field offices for guidance. The whole purpose of this

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[9] Although taxpayer's brief states (p. 38) that every Internal Revenue Bulletin since 1924 contained this statement, it appears that the particular statement referred to appeared in the Cumulative Bulletin for the last time on the front page of the 1951 issue.

[10] 1954 Internal Revenue Code, Section 7213(a)(1); 1939 Code, Section 55(f)(1).

procedure was that field offices were to follow a similar practice in handling similar situations. That is, taxpayers in similar positions were to be treated in a similar fashion. This is certainly a reasonable aim for the administration of a revenue statute.

As has been pointed out in Argument I above, the Government is not attempting to bind the taxpayer by the proven administrative practice or force taxpayer to follow any particular procedure. The primary purpose for which the proven administrative practice is offered is to show what would have happened if taxpayer had desired to file a consolidated return and had proceeded to request advice as to the method for doing so. The practice shows that Allstate did have the "privilege" of filing consolidated returns with its parent Sears, because it would have been allowed by the Commissioner to do so.

The taxpayer attempts to argue that Revenue Ruling 55-80, 1955-1 Cum. Bull. 387, is inconsistent with the proven administrative practice. The slightest study of the published Revenue Ruling, as compared with paragraph 3 of Assistant Commissioner Swartz' affidavit, shows that the Ruling deals with another aspect of this situation, namely, a change of the parent's accounting period to conform to the subsidiary.[11] Thus, the Ruling is merely another method of conforming accounting periods of a subsidiary and parent. Is it taxpayer's position that the Commissioner is limited to only one method to handle the mechanics of conforming accounting periods? Such a posi-

[11] The administrative practice in question deals with a change by the subsidiary insurance company to conform to the parent's fiscal year accounting period for the initial year, and then a change back to the calendar year by the affiliated group.

tion is preposterous. Certainly the Commissioner can find more than one way to arrange for the mechanics of conforming accounting periods. Moreover, the published Revenue Ruling does not deal with an insurance-company subsidiary. But even if there was a conflict (which the Government does not see)[12] between the published Ruling and the practice described in Assistant Commissioner Swartz' affidavit, this would be irrelevant here, since the existence of a practice or method allowing the conforming of accounting periods in any manner for Allstate's first taxable year after June 30, 1950, will defeat taxpayer's claim. Consequently, taxpayer's assertion that this published Revenue Ruling is in conflict with the administrative practice described in Mr. Swartz' affidavit, and that therefore evidence of the practice must be excluded, is without merit.

CONCLUSION

In summary, the Government submits that the proof of an administrative practice, whether published or unpublished, is highly relevant in this case in order to show what the Commissioner would have done if Allstate had wanted to file a consolidated return for the period in question with its parent and if the Commission had been requested for advice or permission with respect to conforming the accounting periods of Allstate and Sears. If taxpayer's argument that the statutory test under Section 435(e)(1)(A)(i) is whether Allstate had the "privilege" of ac-

[12] Note that the Commissioner saw no conflict, since he issued a letter ruling (dated January 18, 1956) carrying out his practice after publication of Rev. Rul. 55-80, and issued his regulation in 1959 embodying the practice (Treasury Regulations on Income Taxes (1954 Code), Section 1.1502-14(c)) without revoking this published ruling.

tually filing a consolidated return with Sears prevails, then the Government believes that the administrative practice described in Mr. Swartz' affidavit helps to show that Allstate could have filed if it had so desired because the Commissioner would have allowed the conforming of accounting periods in accordance with Service practice. Consequently, this evidence helps to show that the taxpayer actually did have the "privilege" of so filing. For these reasons, taxpayer's motion to strike Mr. Swartz' affidavit should be denied.

Respectfully submitted,

LOUIS F. OBERDORFER,
Assistant Attorney General.

RICHARD M. ROBERTS,
JEROME FINK,
R. MICHAEL DUNCAN,
Attorneys,
Department of Justice,
Washington 25, D.C.

JAMES P. O'BRIEN,
United States Attorney.
November, 1961.

APPENDIX

Internal Revenue Code of 1939:

SEC. 435. [as added by Sec. 101, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137, and amended by Sec. 504(a), Revenue Act of 1951, c. 521, 65 Stat. 452]. EXCESS PROFITS CREDIT—BASED ON INCOME.

• • •

(e) *Average Base Period Net Income—Alternative Based on Growth.*—

(1) *Taxpayers to which subsection applies.*—A taxpayer shall be entitled to the benefits of this subsection if the taxpayer commenced business before the end of its base period, and if either—

(A)(i) the total assets of the taxpayer as of the first day of its base period (when added to the total assets for such day of all corporations with which the taxpayer has the privilege under section 141 of filing a consolidated return for its first taxable year under this subchapter), determined under paragraph (3), did not exceed $20,000,000, and

• • •

(26 U.S.C. 1952 ed., Sec. 435.)

Treasury Regulations 129 (1939 Code):

Sec. 24.14. *Accounting period of an affiliated group.* (a) The taxable year of an affiliated group which makes a consolidated return shall be the same as the taxable year of the common parent corporation; and, upon having elected to file consolidated returns, each subsidiary corporation shall, not later than the close of the first consolidated taxable year ending thereafter, adopt an annual accounting period, fiscal year or calendar year as the case may be, in conformity with that of the common parent.

(b) If a change of accounting period is necessary in order to conform the accounting periods of the common parent and of its subsidiaries, and if the requirements of section 29.46-1, Regulations 111, relating to notice of change, cannot otherwise be complied with, such notice shall be furnished at or before the time of filing the consolidated return.

• • •

Administrative Procedure Act, c. 324, 60 Stat. 237:

Sec. 4. Except to the extent that there is involved (1) any military, naval, or foreign affairs function of the United States or (2) any matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts—

(a) *Notice.*—General notice of proposed rule making shall be published in the Federal Register (unless all persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law) and shall include (1) a statement of the time, place, and nature of public rule making proceedings; (2) reference to the authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. Except where notice or hearing is required by statute, this subsection shall not apply to interpretative rules, general statements of policy, rules of agency organization, procedure, or practice, or in any situation in which the agency for good cause finds (and incorporates the finding and a brief statement of the reasons therefor in the rules issue) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(b) *Procedures.*—After notice required by this section, the agency shall afford interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity to present the same orally in

any manner; and, after consideration of all relevant matter presented, the agency shall incorporate in any rules adopted a concise general statement of their basis and purpose. Where rules are required by statute to be made on the record after opportunity for an agency hearing, the requirements of sections 7 and 8 shall apply in place of the provisions of this subsection.

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(5 U.S.C. 1958 ed., Sec. 1003.)

DEPOSITION OF HAROLD T. SWARTZ
NOTICE OF CORRECTION

This is to certify that Mr. Harold T. Swartz, deponent in the above-entitled matter, upon appearance before Jo Ann Withers, Notary Public who duly swore Mr. Swartz at the time of taking of said deposition, for the purpose of reading and signing said deponent, requested the following changes be made:

Page 13, line 10, change "it" to —*I*—.

Page 34, line 22, change last word "affiliation" to —*affiliated group*—.

Page 44, line 24, delete first "that" to make line read—A The reason is that the specialists keep copies—.

Page 49, line 23, change "The" to —*They*—.

Page 54, line 25, change "done" to —*did*—.

Page 67, line 6, change "and" to —*in*—.

Page 67, line 6, change "conferences" to —*Corporation Section*—.

Page 70, line 11, change "on" to —*only*—.

Page 90, line 23, after "office" insert —*to be used*—.

Page 95, line 1, delete the word "several".

Page 108, line 11, change "file" to —*files*—.

Page 111, line 4, change "To" to —*Do*—.

Page 120, line 19, change "modifies it." to —*is modified*—.

Page 120, line 24, change the "," to —;—.

Page 131, line 18, after the word "say" insert—, "—,

Page 131, line 18, at end of line after "," add—"—.

Page 132, line 6, change "we" to —*he*—.

Page 132, line 7, at beginning of line before the word "see" insert —"—.

Page 132, line 7, after "5/26/45," insert —"—.

Page 132, line 8, before the word "another" insert —"—.

Page 132, line 8, after "file," insert —"—.

Page 133, line 22, change "in" to —*and*—.

Page 138, line 4, insert after the word "what" the word —*was*—.

Page 147, line 9, change the word "time" to —*file*—.

Page 147, line 20, change "Mr. Cleos" to— Mr. *Klioze*—.

Page 148, line 6, insert after the word "prepared" the word —*return*—.

Page 157, line 6, change Section citation to read —Section *1.1502*-14(a)—.

Page 158, line 5, delete "or".

Page 158, line 5, after the word "Office" insert —, *that is*,—.

Page 159, line 8, change Section citation to read —Section *1.1502*-14(a)—.

Page 168, line 8, change "a wary" to —*where a*—.

Page 169, line 16, change "request" to —request*ed*—.

Page 175, line 25, change "answer" to —answer*ed*—.

Page 177, line 17, before the word "acquired" insert —*an*—.

Page 179, line 16, after the word "one" insert —*time*—.

Page 179, line 16, change "no" to —no*w*—.

Page 179, last line, change "letter" to —letter*s*—.

Page 186, line 1, insert after "probably" —*be*—.

Page 189, line 21, change "further on the card" to —further, on the card,—.

Page 193, line 18, after "to" insert —*the*—.

Thereafter deponent signed the original copy of the deposition.

This is to further certify:

That a copy of this correction notice has this day been mailed to all counsel entering appearances at the time of taking of this deposition.

That the original signed copy of this deposition, together with all exhibits and the original copy of this correction notice, has this day been filed with the Clerk of the Court by placing same in the U.S. mail.

Dated: December 29, 1961

/s/ *Jo Ann Withers*
Notary Public in and for the
District of Columbia

My Commission Expires February 14, 1965.

DEPOSITION

Washington, D. C.

Tuesday, December 19, 1961

Deposition of Harold T. Swartz, a witness, called for examination by counsel for Defendant by stipulation and agreement by and between counsel, in the Office of the Assistant Commissioner, Technical, Internal Revenue Service, Room 3018, Internal Revenue Building, Washington, D.C., beginning at 10:00 o'clock a.m., before Jo Ann Withers, a Notary Public in and for the District of Columbia, when there were present on behalf of the respective parties.

For the Plaintiff:
Charles W. Davis, Esq.,
William McClintock, Esq., and
Edward W. Rothe, Esq., Attorneys of the Law Firm of Hopkins, Sutter, Owen, Mulroy & Wentz, One North LaSalle Street, Chicago 2, Illinois.

For the Defendant:
R. Michael Duncan, Esq., and
David Wilson, Esq., Attorneys for the Tax Division, United States Department of Justice.

PROCEEDINGS

Mr. Duncan: Let the record show that this deposition is taken by stipulation of the parties and is governed by the federal rules of civil procedure and Mr. Swartz appears without notice or subpoena.

Whereupon
HAROLD T. SWARTZ was called as a witness and duly sworn by the Notary.

(Pause.)

Mr. Duncan: We understood that this was your discovery deposition in line with the Judge's remarks at the hearing on Monday. Referring to page 10 of the transcript, Mr. Maloney speaking to the Court:

"May I ask you, in your last sentence I think you said the plaintiff may seek by deposition to show what it intends to show. Were you referring to the plaintiff, Allstate, the taxpayer?"

"The Court: Yes. I understand that you are in the process of taking the deposition of Commissioner Swartz. Then, if that is true, why, you may want to pursue that and see if you can establish by your deposition what you have not been able to establish by your affidavit. If you can, then you may try to renew your motion for a summary judgment." Then the Court goes on.

"Mr. Davis: The record may show, Your Honor, that the plaintiff did agree to the procedure for deposition. It was plaintiff's understanding that the burden of going forward here with respect to the asserted practice was upon the defendant and therefore that it was defendant who was conducting the deposition with such opportunity for cross-examination."

"The Court: Whenever affirmative defenses are asserted, plaintiff seeks to discover by deposition what they

are and tries to defeat them by deposition, so your motion for summary judgment would lie anyway."

I may be wrong, but I interpreted this to mean that you were going ahead with the discovery deposition of Mr. Swartz.

Mr. Davis: As we tried to make clear to you by letter and by telephone conversation, we thought the Court certainly made it clear when the Judge said at page 10:

"I am saying that the burden is upon the government to go forward."

We understood the order of the Judge, here, the decision of Judge Parsons to be that the affidavit would be stricken. If that is the effect of his order, then there is presently no evidence with respect to an asserted and published administrative practice in the record of this proceeding.

Mr. Duncan: But there is a hearing for this matter set for January 5th, is there not?

Mr. Davis: There is a hearing, yes.

Mr. Duncan: As I understood the matter could be tried out at that time.

Mr. Davis: I believe that the Judge expressed the desire, if the parties might by deposition obviate the necessity for a hearing on January 5, or that he would perhaps set this very issue for trial.

Mr. Duncan: Reading from page 12 of the transcript:

"Report on January 5th and to set for trial as to this one issue on that day."

Mr. Davis: Yes, right. Is that beyond what I said?

Mr. Duncan: I thought this was to be tried on January 5th.

Mr. Davis: And to set for trial as to this one issue on that date. I understood that he wanted a report on January 5 as to what happened in the interim, and then he would set for trial as to this particular issue on that day.

Mr. Duncan: We seem to have reached a difference in understanding. However, I don't think it is a severe one.

Do you decline to go ahead with the discovery deposition of Mr. Swartz at this time?

Mr. Davis: At this point we have nothing to discover of which I have notice.

Mr. Duncan: In other words, you assume that we would now go forward and prove administrative practice at a trial? You will recall that I made available to you all of the rulings.

Mr. Davis: You have made available certain ruling letters and if, as and when those ruling letters appear to be a part of or are about to become a part, when we have been notified that they are about to become a part of the record in this proceeding, then we would take such action as we consider appropriate to develop their relevance, competence, authenticity.

Mr. Duncan: Did you really feel that we would not go forward to prove with those ruling letters at the trial? We understood the trial was for January 5th on this issue, but you understand that the Court is to set the day on that day for the trial on that issue.

Mr. Davis: I just invite your reading of the first item on page 12 of the transcript:

"Report on January 5th and to set for trial as to this one issue on that day."

Mr. Duncan: Yes, that's what he said. I thought he said set for trial on that day. But we are quibbling over what the judge meant and we evidently misunderstood him.

Mr. Davis: Your descripton of "quibbling," I don't mean to be quibbling. I tried to follow the judge's remarks in open court and then found them confirmed in the transcript.

Mr. Duncan: I think, Mr. Davis, rather than make your trip from Chicago worthless and in order to avoid delay in

the proceedings, we will assume the burden and go forward here. This is not what we understood you were coming here for. Perhaps it is our fault for misunderstanding you.

Mr. Davis: Would you like us to offer for the record the correspondence in which I believe that our understanding was set forth on all fours in conformity with what the judge has directed? We construed what the judge said on November 20th to be precisely what the judge held here, and so notified you by correspondence. Then we had a telephone conversation about it in which you indicated disagreement. I had no knowledge of what the judge was going to say when we appeared to express our willingness to agree to the government's motion for a continuance on December 11, and at that point the judge made it so crystal clear that, as he viewed it, the affidavit was inadmissible and that the burden was on the government to establish the existence of administrative practice by whatever competent evidence was available to it.

Consequently we have tried, we think, to maintain a uniform position with respect to this matter, since it first arose.

Mr. Duncan: We evidently have a misunderstanding. I don't suppose there would be much point in arguing about it now. We might as well go ahead on the record then with the examination of Mr. Swartz.

If we do go ahead and take the deposition of Mr. Swartz, are you agreeable that this be introduced at the trial as his testimony, in effect, without requiring him to go on to Chicago?

Mr. Davis: That would depend upon whether the testimony offered is compiete with respect to the matters covered and whether, as we would of course during the course of our deposition, or of our interrogation and of your examination, raise objection to the form of any question propounded.

Mr. Duncan: Of course, assuming that, I mean. But, aside from that fact, will you insist on, assuming the completeness of this examination, will you be agreeable to this constituting Mr. Swartz' examination? I would like to add that, of course, to the extent that it is not complete, you would have your chance for cross-examination.

Mr. Davis: Yes, the only thing is whether—as I have no present intention to require Mr. Swartz to come to Chicago, that is furthest from my mind—if we should find that on the basis of the record and the manner in which this testimony develops that we sitting here do not comprehend the full significance of some of the testimony or that we feel that there may be something to which his testimony, further testimony, might contribute toward the cause of the case, then we would not wish to be estopped from that.

We have prepared ourselves for this deposition, but I have no way of reading in advance just precisely what you may wish to develop. Mr. Swartz was not qualified in your affidavit, particularly in your affidavit, as an expert witness in the field that we have.

If we get into intricate concepts of consolidated returns and consolidated return accounting, I just do not wish to foreclose myself at this time from a possibility of having to call Mr. Swartz for the hearing, but I certainly do not anticipate that that would be necessary.

Mr. Duncan: I believe the feleral rules will govern whether his deposition is admissible in evidence in Chicago.

Mr. Davis: Right.

Mr. Duncan: You will have full opportunity to cross examine.

Mr. Swartz, we may as well proceed.

Whereupon

HAROLD T. SWARTZ was called as a witness by counsel for the defendant and, having previously been sworn by the Notary, was examined and testified as follows:

Examination on Behalf of the Defendant by Mr. Duncan.

Q. Please state your name.

A. Harold T. Swartz S-w-a-r-t-z.

Q. What is your present residence, Mr. Swartz?

A. My present residence is 1555 Mount Eagle Place, Alexandria, Virginia.

Q. What is your present occupation?

A. My occupation is Assistant Commissioner, Internal Revenue, in Charge of Technical Functions.

Q. How long have you been employed by Internal Revenue, sir?

A. A little over 26 years.

Q. Would you give us a description of the jobs you have held and approximately when you have held them with the Internal Revenue Service?

A. Yes. I started with the Internal Revenue Service in 1935 as an Internal Revenue Agent.

Q. Where were you stationed?

A. New York City.

Auditing various returns: corporations, individuals, trusts, partnerships. I think in 1939 I became a conferee in the New York Office.

The functions of a conferee are to hear protests and decide issues where taxpayers are protesting the results of a revenue agent's preliminary findings, audit.

In 1943, I came to Washington to become the Chief Conferee of the Pension Trust Division of the Internal Revenue Service. At that time this was a temporary assignment. I was here for a year and a half on that assignment.

I went back to New York and for a short period handled Section 722 relief cases and later on in 1945 I was t rans-

ferred to Washington as the Technical Advisor to the Deputy Commissioner of the Income Tax Unit.

In 1947—

Q. Could you break this just a second and tell us what the Income Tax Unit was in 1947?

A. In 1947, the Income Tax Unit was in full charge of all income tax matters relating to internal revenue taxation.

The Deputy Commissioner not only had charge of all the audit functions in the field, with respect to auditing income tax returns, but also was in charge of the post review function in Washington, was in charge of the rulings function in Washington. In other words, the Deputy Commissioner of the Income Tax Unit was in charge of all aspects of income taxes.

Q. How long were you there?

A. I was there two years.

In 1947, I was made a member of the Commissioner's Management Staff. My assignment to the Commissioner's Management Staff was primarily in connection with representing the Commissioner in legislative and regulation matters which concerned the Commissioner, the Treasury Department and I assisted the Ways and Means Committee and the House Legislative Counsel in connection with —in an advisory capacity—in connection with legislation and regulations.

In 1951, I was appointed Assistant Deputy Commissioner of the Income Tax Unit. I served in that capacity for a little over a year at which time the Internal Revenue Service was reorganized. The reorganization was based on a functional setup; instead of deputy commissioners being in charge of the entire function with respect to a particular tax, the national office of the Internal Revenue Service was divided into functions. In other words, all of the ruling functions, regulation functions of all the taxes, including excise, employment taxes, estate taxes, gift taxes and income taxes were separated and put into the Technical Organization.

The other functions of the Internal Revenue Service were also divided into separate functions: the audit resopnsibilities, the appellate responsibilities, the collection responsibilities were put in under another function. In other words, I then became the Director of the Tax Rulings Division. This was in 1952, and the Director of the Tax Rulings Division was in charge of all rulings issued to taxpayers, it was in charge of answering all requests for teachnical advice from field officers, it was in charge of—well, those were the two primary functions at that time of the Tax Rulings Division.

Q. How long were you Director of the Tax Rulings Division?

A. I was Director of the Tax Rulings Division from 1952 until 1958.

In 1958, I assumed my present capacity as Assistant Commissioner, Technical.

Q. What function does the Assistant Commissioner, Technical, have?

A. The Assistant Commissioner, Technical, has charge of the Rulings Division; it has charge of the Technical Planning Division, which is the Commissioner's functions in connection with legislation and regulations, and also preparing the tax forms; it has charge of the Special Technical Services Division which are our engineers and preparing and putting out the Internal Revenue Bulletin; also in charge of the Tax Treaty Arrangements, the Commissioner's functions in connection with arranging tax treaties with foreign countries.

Q. How long would you say you have been associated with the ruling processes?

A. At least since 1951 when I became Assistant Deputy Commissioner of the Income Tax Unit.

Q. That is directly associated with rulings?

A. Directly associated. I would like to add that when I speak of the various taxes that this does not include alcohol and tobacco taxes; alcohol and tobacco taxes are under a separate function.

Q. But you have been directly associated with income tax rulings since 1951?

A. Since 1951.

Q. By virtue of your job, do you have by virtue of being Assistant Commissioner, Technical, general charge of the ruling situation?

A. Yes, I have charge of the Tax Rulings Division, which handles practically all the rulings, other than alcohol and tobacco tax. I have charge also of the Special-Technical Services Division, which is located in the Engineers. The Engineers also issue some rulings. So that, with respect to all rulings, other than alcohol and tobacco tax, I now have full charge.

Q. What records are kept of rulings that have been issued in your office?

A. In the Technical Organization as a whole, a copy of every ruling to a taxpayer, a copy of every memorandum of technical advice to our field offices are filed under subjects.

Q. This is the present system?

A. This is the present system.

There are precedents, certain precedents that are designated as, maybe, the first time we have issued a ruling which are placed in what we call our "Precedent File".

Q. These are routine in the ordinary course of your business?

A. Yes, they are.

Q. Of the office's business, I mean.

A. Right.

Q. In these records, the records of the rulings that are kept are the actual carbon copies of the rulings; is that right?

A. Right.

Q. In the Precedent File, do you retain copies of the taxpayer's requests for those rulings?

A. Yes, in the Precedent File, the entire file is maintained; in the Precedent File there are requests for rulings, exhibits, carbon copies of the rulings.

Q. Could you tell us, Mr. Swartz, how many requests for rulings the office has been receiving over the years?

A. It varies. Requests for rulings would include, we include in our figures the requests for technical advice from field officers, requests for rulings from taxpayers, requests for changes in accounting period, requests for changes in accounting method. The volume runs between 30 and 40 thousand a year.

Q. Has this been true over the last 10 years?

A. Yes.

Q. Could you tell us a little bit about a ruling process? What is the process? How is a ruling issued? What causes it to be issued?

A. Ordinarily, with respect to rulings to taxpayers, the large bulk of our rulings to taxpayers are in connection with a contemplated transaction rather than a consummated transaction. It's a transaction that a taxpayer wishes to enter into and he usually writes to our office setting forth the facts, all parts of the transaction which he contemplates entering into and asking us specific questions, generally, as to what would be the tax result if this transaction is consummated.

In connection with changes of accounting periods, they usually designate the period that they are reporting on, setting forth the period that they would like it changed to,

the reasons that they would like to change and asking for permission to change. It is the same with accounting methods. They may be under an accounting method and wish to change to another method and ask the Commissioner's permission to change to that method.

Q. What is the function of a ruling, what does it mean?

A. The function of a ruling is to advise the taxpayer with respect to the tax result that he can expect, and the treatment that he can expect from the Internal Revenue Service if he consummates the transaction in accordance with the presentation he has made to us.

Q. The ruling letter itself, what does it set out?

A. The ruling letter itself usually repeats the pertinent facts that the taxpayer has presented, describing the transaction that he wishes to enter into, and it contains some reasoning, usually, as to how we arrive at the answer and answers the request. It addresses itself to the inquiry.

Q. Whan a ruling has been issued, what effect does this have on the lower offices of the Revenue Service, or on the transaction once it has been completed?

A. To the taxpayer?

Q. Yes, to the taxpayer.

A. A ruling to the taxpayer can be relied on by that taxpayer, provided he completes the transaction in accordance with the facts that are set forth.

Q. What do you mean by "the facts that are set forth"?

A. The facts that were described by the taxpayer in his request for a ruling or his letter.

If the transaction is consummated in accordance—in other words, if he proceeds to consummate that transaction in accordance with the facts he has set forth, then this ruling letter is guidance to him as to the treatment that he will receive from this Service and its Revenue Agents.

I might add that this position is set forth now in a published ruling, I believe, number 54-172, in which we point out that if a taxpayer receives a ruling he may rely on that ruling provided the transaction is consummated in accordance with his request, but, however, a Closing Agreement is the only legal means which is binding on both the Commissioner and the taxpayer.

If the transaction is consummated in accordance with the request, ordinarily, even if the Commissioner changes his mind, he will not apply this change retroactively to the taxpayer receiving the ruling.

I might say that in connection with that some of the rulings, for example, change of the accounting period and change of accounting method, constitute in effect a contract. In other words, once permission is granted and a taxpayer changes his methods that is in effect a contract.

Certain rulings, such as rulings that are called for in the law, such as under Section 367, are also binding.

Mr. Davis: I move to strike his answer as being a conclusion, as to Mr. Swartz' statement that this constitutes a contract between the taxpayer and the Internal Revenue Service.

Mr. Duncan: Just to clarify that testimony:

By Mr. Duncan:

Q. You were referring to certain kinds of rulings?

A. I was referring to rulings which are required. In other words, many of these rulings which are requested by taxpayers are not required under the law, under the regulations; however, in certain instances, the law, the regulations do require the taxpayer to get a ruling or permission from the Commissioner.

In respect to a change in accounting period and in respect to a change of accounting methods, I believe there are some automatic provisions under which the taxpayer can change without permission. When they must receive permission,

to that extent, in my opinion, they have a greater degree of formality than just the ordinary ruling.

Mr. Duncan: I would like to have this document marked as Defendant's Exhibit 1 for identification.

(The document above referred to was marked Defendant's Exhibit No. 1 for identification)

By Mr. Duncan:

Q. Mr. Swartz, could you tell us what that document is?

A. (Examining document) This document is a ruling letter to a taxpayer.

Do you want a full description?

Q. It is a ruling letter to a taxpayer?

A. This is a ruling letter to a taxpayer.

Q. What date is that ruling letter issued?

A. Dated February 14, 1944.

Q. In fact, it is a copy of a ruling letter sent to a taxpayer?

A. Yes.

Q. The names of the taxpayers and other identifying addresses or names have been excised, have they not?

A. Yes, they have.

Q. Was this document found in the ruling files?

A. The copy, copy of this document was found in the ruling files, yes, sir.

Q. Was such a ruling actually issued to a taxpayer?

A. If this copy was in the ruling file, it represents a copy of a ruling that was issued to a taxpayer.

Q. What file was that ruling found in? Was that document found in your Precedent File?

A. I don't believe this particular ruling was found there; I'm not sure whether this was in the Precedent File or not. I don't believe that this was in the Precedent File. May I look at the file?

Mr. Davis: Let the record show what he is looking at.

Mr. Duncan: Let the record show that he is looking at the ruling file from which a copy was made.

By Mr. Duncan:

Q. Is that correct?

A. Yes, this ruling letter is in one of the Precedent Files. It was in a file of this type. It is in the Precedent File.

This ruling dated Feruary 14, 1945 was found in the Precedent File.

Q. Nineteen?

A. '44.

Mr. Davis: May we have described how rulings in the Precedent File are distinguished from rulings which are not found in the Precedent Files?

Mr. Duncan: I was going to ask him that.

By Mr. Duncan:

Q. Could you tell us—I think you described earlier what the Precedent File was, but would you describe what the file is?

A. Yes. Of course, we issue many rulings during the course of a year and when a ruling is issued which in the opinion of the classifiers establishes a precedent, a copy of this is made with the file and placed in what we call our Precedent File. Subsequent rulings which are based on this particular ruling are not necessarily put in the Precedent File; those are placed in the general files under an index system.

Mr. Duncan: I would like to have this document marked as Defendant's Exhibit 2.

(The document above referred to was marked Defendant's Exhibit No. 2 for identification.)

By Mr. Duncan:.

Q. Could you identify that document, Defendant's Exhibit 2?

A. (Examining document) It is a copy of a ruling letter dated May 26, 1945 issued to a taxpayer.

Q. With the name of the taxpayer and any identifying marks in the ruling removed; is that right?

A. That's correct.

Q. Referring to the second page of that, Defendant's Exhibit 2, you will note a lot of initials at the bottom of that page. What do those initials mean?

A. Those are initials of the people who have initiated, considered and reviewed this particular ruling letter.

Q. This ruling was issued over the Commissioner's signature, or rather over the Acting Commissioner's signature?

A. Yes, the Acting Commissioner signed this letter.

Q. Was this document found in the Precedent File?

A. Yes, it was. It was also found in our Precedent File.

Mr. Duncan: I would like to have this marked as Defendant's Exhibit 2-A for identification.

(The document above referred to was marked Defendant's Exhibit No. 2-A for identification.)

By Mr. Duncan:

Q. Could you identify this document and tell us what it is a copy of?

A. (Examining document) This is a copy of a request for a ruling, it is dated April 17, 1945, it is addressed to the Deputy Commissioner of Internal Revenue and is a request for a ruling from a taxpayer, or from a taxpayer's representative.

Q. Could you refer to your files and tell us whether this is a copy of the request for ruling represented by Defendant's Exhibit 2, the ruling if which is represented by Defendant's Exhibit 2?

A. Yes. This is, this Exhibit 2-A is the request for the ruling on which the Exhibit 2 ruling letter was based.

Q. I believe you testified that this ruling and request for ruling were found in your Precedent File?

A. That is correct.

Mr. Duncan: I would like to have marked as Defendant's Exhibit 3 for identification this document.

(The document above referred to was marked Defendant's Exhibit No. 3 for identification.)

By Mr. Duncan:

Q. Could you identify Defendant's Exhibit 3 for identification?

A. (Examining document) This is a ruling letter dated September 12, 1945 and was issued on that date to a taxpayer in answer to a request for a ruling.

Q. All right. Was this ruling found in the files of this office?

A. This ruling was found in the files of this office, yes.

Q. But not in the Precedent File?

A. Not in the Precedent File.

Mr. Davis: Excuse me. Did you say December 12?

The Witness: September 12.

Mr. Duncan: May we go off the record a moment.

(Discussion off the record.)

Mr. Duncan: Back on the record.

Mr. Davis: This is not in the Precedent File, is that correct?

Mr. Duncan: His testimony was it is not in the Precedent File.

I would like to have this marked as Defendant's Exhibit 4 for identification.

(The document above referred to was marked Defendant's Exhibit No. 4 for identification.)

By Mr. Duncan:

Q. Could you identify Defendant's Exhibit 4 for identification?

A. (Examining document) Exhibit 4 is a copy of a ruling letter issued to a taxpayer under date of February 5, 1947.

Q. Referring to the second page of that exhibit, was that ruling issued over the signature of the Commissioner?

A. Yes. This was issued over the signature of the Commissioner of Internal Revenue.

Q. Mr. Nunan, according to the stamped signature, was the Commissioner at the time?

A. That is correct.

Q. What are the initials at the bottom of the page 2 of Defendant's Exhibit 4 for identification? What do they signify?

A. Those initials are the initials of the initiator and the reviewers and the signer of this particular ruling letter.

Q. This ruling represented by Defendant's Exhibit 4 was actually issued?

A. This was actually issued, yes.

Q. Was this ruling found in your Precedent File?

A. Yes, this was found in our Precedent File.

Mr. Duncan: I would like to have these documents marked as: Defendant's 4-A for identification;

(The document above referred to was marked Defendant's Exhibit No. 4-A for identification.)

4-B for identification;

(The document above referred to was marked Defendant's Exhibit No. 4-B for identification.)

and 4-C for identification.

(The document above referred to was marked Defendant's Exhibit No. 4-C for identification.)

By Mr. Duncan:

Q. Would you refer to Defendant's Exhibit 4-A, B, and C and tell us what those documents represent in order, and you may wish to refer to the actual file, the Precedent File.

A. (Examining documents) Exhibit 4-A is a request for a ruling to the Commissioner of Internal Revenue, and the request is dated September 25, 1946.

Q. Is that the request which culminated in the ruling represented by Defendant's Exhibit 4?

A. No.

Q. Would you refer to the file, perhaps?

A. Let me see. 4, dated September 25th. No. 4 is 1947. Exhibit 4-A is a request for a ruling dated September 25, 1946.

Q. That is the request, that is the date of the request.

A. That's the date of the request, and that request was answered in a ruling letter marked Exhibit 4-B dated October 10, 1946.

Q. I see. Would you refer to 4-C and tell us what that was?

A. Exhibit 4-C is a request by the taxpayer for a reconsideration of their letter of September 25, 1946.

Q. A reconsideration of our ruling letter dated October 10, 1946, Exhibit 4-B?

A. Yes.

Q. What was the result of that reconsideration?

A. The result of that reconsideration was we issued a ruling to the taxpayer on February 5, 1947.

Q. And that is?

A. Which is Exhibit 4.

Q. I believe you testified this file was in the Precedent File?

A. This file—

Q. This correspondence and this ruling, Defendant's Exhibit 4, was in your Precedent File?

A. Correct.

Mr. Duncan: Would you have that marked Defendant's Exhibit 5 for identification.

(The document above referred to was marked Defendant's Exhibit No. 5 for identification.)

By Mr. Duncan:

Q. Could you identify that exhibit, Defendant's Exhibit 5?

A. Exhibit 5 is a ruling letter to a taxpayer issued under date of August 21st, 1951.

Q. Was that ruling actually issued to a taxpayer?

A. This ruling was issued to a taxpayer.

Mr. Duncan: Would you have that marked Exhibit 5-A?

(The document above referred to was marked Defendant's Exhibit No. 5-A for identification.)

And 5-B.

(The document above referred to was marked Defendant's Exhibit No. 5-B for identification.)

By Mr. Duncan:

Q. Now, would you refer to Defendant's Exhibits 5-A and 5-B and tell us what they are?

Mr. Davis: First, may the record show that plaintiff objects to any line of questioning relating to letter rulings or other documents bearing a date after December 31, 1950.

Mr. Duncan: All right. I think we will take an answer. Under the proceedings here, Mr. Davis, your objections are subject to argument to the Court, but we feel they are relevant and particularly we feel this ruling is very relevant.

By Mr. Duncan:

Q. Would you refer to Defendant's Exhibit 5-A and 5-B and tell us what they represent?

A. (Examining documents) Exhibits 5-A and 5-B—

Q. Let the record show the witness is referring to his file.

A. They represent requests for rulings.

Q. Are those the copies of the requests for rulings or correspondence with respect to a request for rulings?

Leading up to the ruling of October 21, 1951, Defendant's Exhibit No. 5?

A. August 21, 1951.

Q. Yes, you're right.

A. These are the requests for rulings that were considered in connection with the ruling that we issued on August 21, 1951.

Q. Was this document found in your Precedent File?

A. No, this was found in our general file. It was not in the Precedent File.

Mr. Duncan: Would you mark that Defendant's Exhibit 6.

(The document above referred to was marked Defendant's Exhibit No. 6 for identification.)

Would you mark that, while you are at it, Defendant's Exhibit 6-A for identification.

(The document above referred to was marked Defendant's Exhibit No. 6-A for identification.)

By Mr. Duncan:

Q. Would you refer to Defendant's Exhibit 6 and identify that document, if you can?

A. (Examining document) This is a ruling letter issued to a taxpayer under date of May 22, 1953.

Q. And this ruling was actually issued?

A. It was actually issued.

Q. It was found in the files of this office?

A. Correct.

Q. Your office, I mean.

A. Right.

Q. Could you refer to Defendant's Exhibit 6-A for identification and see if you can identify that document?

A. Exhibit 6-A is a request for a ruling addressed to the Commissioner of Internal Revenue under date of May 4, 1953 and is the request on which a ruling of May 22, 1953—

Q. That's Defendant's Exhibit 6.

A. —Exhibit 6 is based.

Q. Was this ruling found in your Precedent Files?

A. No, this was not found in the Precedent File. Again, this was in our general file.

Mr. Duncan: Would you mark that Defendant's Exhibit 7 for identification.

(The document above referred to was marked Defendant's Exhibit No. 7 for identification.)

And 7-A for identification.

(The document above referred to was marked Defendant's Exhibit No. 7-A for identification.)

By Mr. Duncan:

Q. Would you refer to Defendant's Exhibit 7 and identify that document, if you can?

A. (Examining document) Exhibit 7 is a letter ruling issued to a taxpayer under date of January 18, 1956.

Q. When you say it is letter, you mean it is a copy of a letter?

A. It's a copy of a letter.

Q. In fact, all of these documents are copies of, the applicable documents?

A. Right.

Q. Was this ruling actually issued?

A. This was actually issued.

Q. Was it found in the files of your office?

A. It was found in the files of our office, yes, sir.

Q. Was this in your Precedent File?

A. No, this was not in our Precedent File; it was in our general file.

Q. Could you refer to Defendant's Exhibit 7-A for identification and identify that document?

A. (Examining document) This is a copy of a request for a ruling from a taxpayer to the Commissioner.

It is dated December 28, 1955, and is the request to which a ruling of January 18, 1956 was issued, which is Exhibit 7.

Q. I believe you testified that was in your Precedent File, or was not?

A. This, yes, this was in our Precedent File.

Mr. Rothe: What was?

The Witness: Defendant's Exhibit 7.

By Mr. Duncan:

Q. Defendant's Exhibit 7—

A. Was in our Precedent File.

Q. Could you tell us what this Precedent File was and how it was used in this office?

A. The Precedent File was the file in which various designated rulings were placed and was used and referred to by our rulings people in searching out what answers to particular questions we had issued in the past.

Q. Before a ruling was issued, was the preparer supposed to check the Precedent File?

A. Yes.

Q. Could he issue a ruling contrary to the Precedent File?

A. If the request that he had before him was identical or similar, if the question that was asked us in the problem that he had before him was in the nature of a request and the answer given in the Precedent File it was to be used, yes, so long as the law hadn't changed and the regulations hadn't changed.

Q. Could you identify in your own words the area in which these rulings were issued, what these rulings deal with?

A. These rulings deal primarily with—

Mr. Davis: I object. Let the record show an objection unless Mr. Swartz is qualified as the person having knowl-

edge of the substance of these requests for rulings and the actual issuance of these rulings.

Mr. Duncan: I think we'll take a couple of minutes break, Mr. Davis, if we could; it's eleven fifteen.

(Recess.)

By Mr. Duncan:

Q. Mr. Swartz, could you tell us how these rulings came to your attention?

A. Copies of these rulings?

Q. Yes.

A. They were brought to my attention by Mr. Levine in connection with an affidavit that—

Q. Was your office requested to search out these rulings by the Department of Justice for the defense of this case?

A. That's cormrect. We were asked to search out all the rulings we had in this particular area.

Q. Have you read those rulings?

A. Yes, I have.

Q. What is the area involved here with which these rulings deal?

A. The area involved here primarily is in connection with the filing of consolidated returns by an affiliation where one of the affiliates is an insurance company.

Q. How were these particular rulings located?

A. These rulings were located by an index system.

Our general files are indexed in broad categories; our Precedent Files are indexed by name of case and by precedent. They were searched out by looking through the files on the index of consolidations and in addition the technical experts in the Corporation Branch, which, prior to the reorganization was the Coordinating and Advisory Group.

Each specialist usually keeps copies of the rulings that they have considered and issued. Those files were also

thoroughly searched to see whether or not there were any copies of rulings in those files that couldn't be located under the general categories of the index in the Precedent Files or in our general files.

Mr. Rothe: May I have the answer to that played back.

(The answer was read back by the reporter.)

By Mr. Duncan:

Q. Mr. Swartz, having heard your answer read back, is there any amplification or any addition you would like to make?

A. I don't know whether it is an addition or not, but what I attempted to say was that in addition to going through our general files and our Precedent files, we also had our specialists who work on this particular subject go through their own files to search out letters in this particular category.

Mr. Davis: I move that all of this testimony be stricken unless there is identified to whom Mr. Swartz gave instructions and in what form, and then what the report of compliance was with respect to the search that was made.

By Mr. Duncan:

Q. Would you state who you gave instructions to to search these?

A. Upon the request of the Department of Justice.

Q. How—

Mr. Davis: Again, I object to further testimony about the request from the Department of Justice without an indication of when and how it was made and in what form.

By Mr. Duncan:

Q. What did we request you to do, Mr. Swartz?

A. I was requested, our Technical Organization was requested to search our files to gather together all of the rulings that have been issued in this particular area.

Mr. Davis: Then I object unless the area is identified and the date and the specifics of the request.

By Mr. Duncan:

Q. What do you mean by this area?

A. The area that was explained to me, the area being all rulings issued in connection with requests by taxpayers or affiliates to file consolidated returns where one of the affiliates was an insurance company.

Q. Was this in connection with an affidavit that you eventually filed in the District Court?

A. That is correct.

Mr. Davis: I move to strike the answer.

By Mr. Duncan:

Q. Do you remember, Mr. Swartz, how you received this request?

A. Yes. Mr. Levine, and I believe one of the representatives of the Department of Justice called on me in my office. I don't recall the date.

Q. Was this three or four months ago, during the fall?

A. It was during the fall. It was shortly before the affidavit was filed.

Q. Who did you give instructions to?

A. Mr. Levine.

Q. Were there a limited number of specialists in the Corporations Branch dealing with this particular area?

A. Yes, ordinarily in this specialty there are usually two people that handle these particular requests at any given time.

Q. Can you tell us who those were?

A. Mr. Deutsch and, I believe, Mr. Driscoll, or Carey Ross. (After consulting with aide) Mr. Deutsch and Carey Ross.

Q. What specific instructions did you give Mr. Levine?

A. The instructions really were in connection with the request of the Department of Justice to get copies of these

rulings and I asked Mr. Levine to comply with the request from the Department.

Q. Was this a request to get all of the rulings?

A. To get all of the rulings.

Q. Was this a request as to what your practice in this area was?

Mr. Davis: I object.

Mr. Duncan: I think I'll take the answer.

Mr. Davis: This is—

Mr. Duncan: I'm taking an answer over your objection.

Mr. Davis: This is patently a leading question, if counsel please.

Mr. Wilson: You brought it up. You wanted to know when and under what circumstances. We're trying to answer your question.

Mr. Davis: I see. You can let Mr. Swartz develop his testimony in a different way.

Mr. Wilson: In answer to question.

Mr. Davis: But not in answer to a leading question.

Mr. Wilson: Let's take the answer.

Mr. Duncan: I'll take it over the objection.

The Witness: Well, the request that I asked Mr. Levine to comply with, as I understood it, was to search out our files to get all rulings issued in connection with this particular area which is whether or not a group of affiliates, which include an insurance company, may file consolidated returns and under what circumstances.

By Mr. Duncan:

Q. Were these particular rulings that were brought to your attention, identified here, brought to your attention by Mr. Levine?

A. Yes, they were.

Q. And he was working under your instructions?

Mr. Davis: Objection.

By Mr. Duncan:

Q. Go ahead.

Mr. Davis: There are appropriate methods of eliciting this testimony without having the witness led, to specify the date, the next date when he had occasion to consider the matter after he gave the assignment.

By Mr. Duncan:

Q. Could you tell us when, what date these were brought to your attention by Mr. Levine, or approximately when?

A. I don't know. At this point, no, I can't tell you the exact date.

Q. Would the date of the affidavit refresh you?

A. It might help. I think I have a copy of it here, September 22, 1961.

Q. Would that have been the date when they were brought to your attention by Mr. Levine?

A. I think they were brought to my attention before I signed the affidavit, shortly before September 22, 1961.

Q. Was your affidavit in answer to the request of the Department?

A. It's the answer, as I understood it, yes, sir.

Q. By the "Department", I was referring to the Department of Justice.

A. Right.

Q. Could you tell us whether these rulings were all, the identified rulings are all the rulings in this area which could be located?

Mr. Rothe: Object.

Mr. Davis: Objection.

Mr. Rothe: There has been no showing Mr. Swartz is competent to testify to matters sought after in the question.

By Mr. Duncan:

Q. Did you discuss the search for these rulings with Mr. Levine?

A. Yes, I did.

Q. He was working under your general instructions?

A. Yes, he was.

Q. Did you send him back again to search for others?

Mr. Rothe: Leading.

Mr. Duncan: I assume you're objecting.

Mr. Rothe: Yes.

Mr. Duncan: I think I'll take an answer to that.

The Witness: I asked Mr. Levine to get all of the rulings in this area that he could find.

By Mr. Duncan:

Q. Did Mr. Levine—

Mr. Davis: Object as to when, when was this, this question? The witness has testified previously that he asked him to carry out instructions of the Department of Justice. Was this a second date that there were further directions or requests? There is no specification as to time or place.

Mr. Duncan: It's the same request, as I understand it, Mr. Davis. We asked him to find everything.

The Witness: Maybe I could indicate at least that at various times Mr. Levine came to me saying that they had searched this—

Mr. Rothe: Objection, hearsay.

Mr. Duncan: I think I'll take that. I'll take that.

By Mr. Duncan:

Q. Go ahead, Mr. Swartz.

A. That he had searched these files and found certain ruling letters.

Q. Mr. Levine is an employee of yours?

A. That's correct.

Q. He was working under your instructions?

A. Yes, he was.

Q. Was this in part prior to the affidavit and in part subsequent to the affidavit, the date of the affidavit?

Mr. Rothe: I object to the form of the question. I don't understand it.

By Mr. Duncan:

Q. Were these discussions with Mr. Levine with respect to the search he had made in part prior to the affidavit and in part subsequent to the affidavit?

Mr. Davis: This is obviously leading. I object on that ground.

By Mr. Duncan:

Q. When were these discussions with Mr. Levine?

A. I had discussions with Mr. Levine with respect to this search—

Q. That he was doing for you?

A. —that he was doing for me prior to the affidavit and after the affidavit.

Q. What did Mr. Levine report to you with respect to these rulings?

Mr. Rothe: Objection, hearsay.

Mr. Duncan: I think I'll take the answer.

The Witness: At various times Mr. Levine reported that they had located files in the Precedent File, in the general files and in the specific—in the files of the—Mr. Deutsch's file at the present time. Mr. Deutsch had files of copies of rulings in this particular area which—apparently he had issued some, and which his predecessors in this particular area had also issued.

Mr. Davis: I move to strike the answer. There has been no foundation for showing that rulings in the private

files of the specialists had been issued or in what manner they were treated. You have no foundation.

Mr. Duncan: I don't understand the objection. I am referring to these right here that have been identified.

Mr. Davis: You have not identified any such file as having originated with one of these specialists, compared with the—

Mr. Duncan: That's right, I haven't. None of these came from the specialists' files.

Mr. Rothe: He just testified that they did.

The Witness: May I clarify that? The specialists' files were scrutinized in order to get the names of the rulings which were then further searched in the general files and the Precedent File to be sure that we had everything that had been issued in this area.

By Mr. Duncan:

Q. Are you sure?

A. Well, as sure—I can't be sure that there are other rulings out but I assume that by the search that was done that we have all of the rulings that were issued in this area pertaining to those dates.

Q. What reasons do you have to believe that you have them all?

A. The reason that is that the specialists keep copies of these rulings that they issue in this particular area. We had all of those to search further into the general files and the Precedent Files. In addition, we also searched the general files and the Precedent Files and we found no other rulings in those searches other than those that have been introduced here as exhibits.

Q. That have been identified.

A. Identified as exhibits.

Mr. Davis: I move to strike the answer on the ground that the witness obviously does not of his own knowledge know that these are all the rulings found.

Mr. Duncan: I have your objection, Mr. Davis.

By Mr. Duncan:

Q. Based on your knowledge, is it possible there could be a contrary ruling to these?

A. Based on my knowledge—

Mr. Rothe: I object to the witness' speculation. The question calls for a speculation.

Mr. Duncan: I think he's been qualified. I'm taking the answer.

Mr. Davis: Objection. There has been no qualification of this witness as one qualified to evaluate the substance of these rulings. You have not qualified him as an expert, in fact the contrary; that he has had to rely upon other experts to make this search and to determine their existence.

Now, if you are going to qualify him as an expert in this field—

Mr. Duncan: I'm not qualifying him as an expert to testify as to the substance of this matter. I am asking him to testify as to the filing procedures. He has testified with respect—we've asked him to testify as to what files his office keeps and he has so testified. I am asking if it is possible or reasonably possible for rulings to have escaped in this particular area, for us not to have located rulings in this particular area.

Mr. Davis: I object on the ground that it calls for a conclusion.

First of all, he has to have an opinion as to what these rulings—the question would require him to have an opinion as to what the rulings hold; and, secondly, to speculate on matters which are beyond his own knowledge.

Mr. Duncan: All right. Let's let him testify as to what the rulings hold.

By Mr. Duncan:

Q. What do the rulings hold?

A. The rulings, the rulings in effect hold that where there is an affiliated group of corporations of which one is an insurance company that consolidated returns can be filed under those circumstances, provided certain changes are made in the filing of the various returns to coincide with the filing period of the parent. So that the affiliate may file consolidated returns—

Mr. Davis: I move to strike the answer on the ground that it is a conclusion which this witness has not been qualified to give.

Mr. Duncan: I think we will take it along. The rulings, of course, do speak for themselves.

By Mr. Duncan:

Q. You have looked these rulings over?

A. Yes, I have.

Q. I think I'll repeat my question. Is there a reasonable possibility that rulings holding to the contrary were issued during this period?

Mr. Rothe: To the contrary to what?

Mr. Duncan: To the contrary of the rulings identified or under similar circumstances.

Mr. Davis: Object. There has been no assertion, except in the vaguest terms of conclusion and therefore to negate the existence of something contrary to such an assertion is also obviously a conclusion and therefore an improper question.

Mr. Duncan: Let's take an answer on that.

Would you read back the question so that he can hear it, if you would, please.

(The question was read by the reporter.)

The Witness: It had to be probable that any other rulings or any rulings issued in this area during the period involved did follow the same patterns as the rulings that we have before us as exhibits.

This is for the reason that when a ruling is placed in the Precedent File that if any ruling contrary, or this practice has not been followed in the future, that the precedent on which rulings were based would have been removed from the Precedent File then and not to be followed any more. So that, if any rulings, any requests for rulings in this area that had come up other than the ones that we have marked as exhibits, they would either have followed the principles of the rulings that were issued, and any rulings to the contrary would not have been issued without removal from the Precedent File of the previous rulings.

Mr. Davis: I move to strike it on the ground that it calls for a conclusion and that there has been no testimony whatsoever as to what the practice is.

Mr. Rothe: And also that the answer is not responsive to the question.

The Witness: I thought I was responding to the question.

By Mr. Duncan:

Q. I think your answer was responsive to the question, Mr. Swartz.

A. May I add to this last statement?

Q. Certainly, go right ahead.

A. One reason for my answer is that these precedents were approved by the Commissioner's office and the Chief Counsel's office.

Q. How do you know that?

A. Based on the initials appearing on the—

Q. On the identified—

A. —on the identified documents.

Q. For example, let's look at one of these and see if we could tell, sir. Let's look at Defendant's Exhibit 3. Let's look at Defendant's Exhibit 4 for identification, the second page, those are the initials you are referring to?

A. Yes. The initials appearing on the last page of the Exhibit 4.

Q. Which initials in particular, could you go across there and identify the officers as certain of the initials?

Mr. Davis: Well—

By Mr. Duncan:

Q. What do the initials represent?

A. The initials represent the initials of the people who considered this particular issue. They represent the initials of the people in the Income Tax Unit, including the Technical Advisor to the Deputy Commissioner of the Income Tax Unit, and they also—

Q. Could you identify those initials, which were they?

A. FTE is the Technical Advisor to the Deputy Commissioner.

Q. Who was he?

A. That was Frank Eddingfield.

This letter also was referred to the Office of the Chief Counsel.

Q. How do you know that?

A. Because of the initials that were—initials that are appended to the document.

Q. Which initials?

A. There's—I can't identify the names of all of them, there's SHB, but the one in particular is JPW who is, was the then Chief Counsel, Mr. Wenchel, and that was ini-

tialed for Mr. Wenchel V, I believe was Mr. Vogel. It has been further initialed by the Technical Advisor to the Commissioner of Internal Revenue and by the Commissioner so that this particular ruling was initialed by the Income Tax Unit, by the Chief Counsel, by the Commissioner's Office and placed in the Precedent File.

No one in the I ome Tax Unit could have issued a ruling different or contrary or taken a different position than that letter without again having to refer this difference of a position back to the Chief Counsel or the Commissioner's Office, and at that point had any position been changed in this matter the file would have been removed from the Precedent File, and since the file still remained in the Precedent File and is still in the Precedent File it is an indication certainly that there is no probability that any contrary ruling was issued.

If there were any rulings that we don't have that were issued in this area, they would have been issued along the same lines.

Mr. Duncan: I think then at this time I will offer the identified exhibits, 1 through 7, with appropriate A, B, and Cs, whatever they were; I'll identify them:

1, 2, 2-A, 3, 4, 4-A, B and C, 5, 5-A and B, 6, 6-A, 7 and 7-A.

Mr. Davis: I object to the introduction into evidence of these documents, first of all, upon the ground that they have not been shown to provide, shown by anyone established as an expert in the field of consolidated returns of taxpayers and familiar with the subject as having been the object of Mr. Swartz' review and attention; secondly, those which were offered after or relating to times after December 31, 1950 are obviously irrelevant to the point of time—

Mr. Duncan: I'm not sure I understood the first part of your objection, Mr. Davis. Could you spell that out a little bit more, if you could? Just how have these not been shown—you say they have not been shown to be what?

Mr. Davis: They have not been shown to relate to a specific identifiable and demonstrated practice and therefore they are not relevant to the issue of whether or not the taxpayer had a privilege to file a consolidated return for its first taxable year under subchapter E of the Internal Revenue Code of 1939, namely the taxable year ending December 31, 1950. There is no showing of any practice which relates to the requirements of Internal Revenue Service for consent to change an accounting period which would have been requisite to the admissibility of these documents.

Mr. Duncan: It is your position then that the rulings themselves do not show any practice; the rulings cannot speak for themselves?

Mr. Davis: My objection is that these documents have not been shown to be relevant to the issues in this case.

Mr. Duncan: Okay.

Mr. Davis: And they are not competent here to speak for themselves on the foundation which you have laid for them.

Mr. Rothe: I think we need to establish for the record the purpose for which you are offering these exhibits.

Mr. Duncan: I think the record is rather clear on that. On our brief in opposition to your motion to strike the affidavit we state the purpose of the proof of practice and it would be our view that the rulings speak for themselves. They show what the Revenue Service did in many cases as Mr. Swartz has identified and testified, that they were actually issued, and that the rulings themselves set forth what was done and that this was a practice.

Mr. Rothe: I am still not sure I understand the purpose for which you are offering the exhibits, and if you would care to state that for the record, we would like to have it. If you do not care to state it for the reocrd, that's fine, too.

Mr. Duncan: As I said, we stated it in our brief. The purpose of this is that Allstate and Sears could have filed a consolidated return for the first taxable year under the Korean War Excess Profits Tax Act, if they had so desired.

Mr. Rothe: That does not answer my question, but if you are content with that answer, that's fine.

Mr. Duncan: These rulings actually constitute the practice in this area.

Mr. Rothe: That is the purpose for which they are offered?

Mr. Duncan: And therefore they actually show, they are relevant and probative to show what would have happened if Allstate, Allstate and Sears had filed or desired to file a consolidated return, even though, of course, they did not.

Mr. Rothe: Do I understand you to say, Mr. Duncan, that the purpose of offering these exhibits is to show that there was a practice and that these exhibits themselves show the practice, and that is the purpose for which they are being offered?

Mr. Wilson: In part, you're correct.

Mr. Rothe: Will you state for the record the purpose for which the exhibits are offered? We can't very well make an objection to the exhibits without knowing the purpose for which they are offered.

Mr. Wilson: You cut him off short there. You stated about a quarter of what he stated as to what his purpose was just now, on the record.

Mr. Duncan: I'm not going into great detail here. It is our view—I'll say it again, Mr. Rothe—that these exhibits show what the Internal Revenue Service did in particular cases. The testimony is that this was practice, and this was what we done and these were all that were done, they show a policy or practice. They spread over considerable time, they show what would have happened if Allstate and Sears had desired to file consolidated returns and had come to the Internal Revenue Service so desiring and expressed their desire.

Mr. Rothe: That is the purpose for which these documents are offered?

Mr. Duncan: This is also to show that there was an administrative practice reflected through these rulings, through these identified documents, which is relevant here in considering the issues in this case, the legal issues in this case.

Mr. Rothe: Are you saying that the practice was reflected by these documents or that these documents constitute the practice?

Mr. Duncan: I think that's semantics. These documents represent decisions that were made and set out decisions that were made to individual taxpayers in response to request for advice.

One request, the '44 request, came from the Internal Revenue Agent in charge, in a particular area, but the others were actually on requests and the documents so show, I believe.

I think that has sufficiently set forth the purpose for which the documents are being offered.

Mr. Rothe: Then we further object—

Mr. Wilson: I reiterate, the purpose has been set forth at the time and in the transcript of the hearing.

Mr. Rothe: We further object, in addition to the objections posed by Mr. Davis, on the ground that there has been no foundation laid which would make these documents relevant to the purpose you have stated.

Mr. Duncan: I think we will let it go at that, then.

By Mr. Duncan:

Q. Let's refer to Defendant's Exhibit 2, the ruling letter of May 26, 1945; was anything special done with that ruling?

Mr. Davis: I object. Mr. Swartz wasn't even in the Internal Revenue Service. Oh, he was Technical Advisor to the Deputy Commissioner of the Income Tax Unit.

By Mr. Duncan:

Q. Do the files indicate that some special procedure was used with respect to that ruling?

A. The files—

Mr. Duncan: Go ahead, if you want to object.

Mr. Davis: I would like to object if he is going to answer more than yes or no.

Mr. Duncan: All right.

The Witness: How shall I answer it?

By Mr. Duncan:

Q. Add "yes" or "no".

A. Yes.

Q. All right. What was that, what do your files indicate with respect to that ruling?

A. The files—

Q. Wait a minute.

Mr. Duncan: Do you want to object?

Mr. Davis: I object to him reading from the files—

Mr. Duncan: All right, he doesn't have to read from the files. He can tell us what was done.

By Mr. Duncan:

Q. What was done, Mr. Swartz?

A. This ruling, Exhibit 2, was circulated to our field offices and designated as what we call an unpublished ruling.

Mr. Davis: I object; it's hearsay and would be inadmissible.

By Mr. Duncan:

Q. How do you know that?

A. I know it from the fact that there is a copy in the files of a document which indicates that this was circulated to the field. An index card is given to these files that are sent to the field and they are filed in the field offices under that index title.

Mr. Davis: I object unless there is a proper method for proving whether or not this document was circulated in the specific manner.

Mr. Duncan: I am startled, frankly, Mr. Davis, because I thought this was stipulated and I was just going into this, but if it is not, we will—

By Mr. Duncan:

Q. Can you tell us about this procedure of your own personal knowledge? What was this, of your own personal knowledge of this procedure?

A. As a Revenue Agent when I was in New York we periodically got these mimeographed copies of rulings which were issued to taxpayers with instructions and with an index card attached, with instructions to put these in the files and to file the index cards, the index cards being under a title which could be referred to as being rulings issued by the National Office.

Q. What was the purpose of this, of this distribution?

A. The purpose of the distribution system was for the aid of our field offices to get the reasoning behind rulings that were issued by the National Office for their information.

Q. What were they supposed to do with this, what were the field offices—strike that.

What function did these serve in the field offices?

A. They served as reference material for agents when they encountered problems or issues that involved the issue that was listed on the index card.

Q. Did they serve—is there any similarity between the function they served and the Precedent File in this office?

Mr. Davis: Object.

Mr. Duncan: I think I'll take an answer.

The Witness: The Precedent File in the National Office was generally utilized by the people who were answering requests for rulings as being precedents and positions set by the Service in that particular area.

The copies of these particular rulings which were sent to the field were to be used for the same purposes. While the field did not issue rulings as they did in the National Office, nevertheless, the issue involved was to be referred to by the Revenue Agents, or was for their convenience if they wished to refer to it.

Mr. Duncan: I think that completes our examination, Mr. Davis.

Would you like to have a short break before you start.

Mr. Davis: I think that would be helpful.

(Whereupon, the taking of the deposition was suspended at 12:13 o'clock p.m. for the taking of the luncheon recess to be resumed at 1:30 o'clock p.m. of the same day.)

AFTERNOON SESSION

(The taking of the deposition was resumed at 1:30 o'clock p.m.)

Whereupon

HAROLD T. SWARTZ resumed the stand and having previously been sworn was examined further and testified as follows:

Examination on Behalf of Plaintiff.

By Mr. Davis:

Q. You are the same Mr. Swartz who testified in this cause this morning as Assistant Commissioner of Internal Revenue?

A. That's right.

Q. Would you refer to the first conference which you had with representatives of the Department of Justice with respect to initiating the search of your files. Just who was present at the time?

A. I really don't recall. Maybe I can, I don't know whether I can refer that to Mr. Levine and the representative of the Department of Justice.

Q. Was that Mr. Duncan, the present counsel?

A. No, I don't believe it was. It was not, no.

Mr. Duncan: I will go off the record for a minute, if you would want.

(Discussion off the record.)

Mr. Duncan: Back on the record.

By Mr. Davis:

Q. How many people called on you in your office at that time?

A. This was just a basic routine call, as I remember; there may have been two or three. I recall Mr. Levine was there and I guess there was a representative of the Chief Counsel's Office and someone who I understood was from the Department of Justice.

Q. Who spoke first?

A. I believe Mr. Levine. He merely introduced the people and told me that they were looking for these ruling letters that had to do with this case.

Q. This Mr. Levine said that they were looking for ruling letters relating to this case, and by "this case", you mean Allstate Insurance Company?

A. They said that they were looking for some—I can't recall the exact conversation—Mr. Levine, I think, merely spoke, this was so and so and so and so, and said that in connection with the Allstate case that they were searching,

they wanted to search the files for ruling letters which had been issued on this consolidated issue. I can't recall the words, but it was words to that effect.

Q. What did you think they were asking about when they referred to the consolidated issue?

A. I was somewhat familiar with the issue involved in this case. I believe that I had had occasion probably when I was Director of the Tax Rulings Divisions to go somewhat into this issue.

The issue, as I recall it, was the question as to whether or not in an affiliated group, the parent corporation being on a fiscal year basis could file a consolidated return, the affiliates could file a consolidated return when one of the affiliates was an insurance company. The question, as I understood it, being that under regulations an insurance company had to file on the calendar year basis; the regulations under consolidations required the affiliates to be on the same taxable year as the parent, so obviously there was a question there as to whether or not under such circumstances consolidated returns could be filed.

Under those circumstances, as I had remembered it, even when this question was presented, in looking through the files, it was that we had come to the conclusion that inasmuch as Congress had intended to allow, allow affiliates—

Q. Was this discussed? Is this something that you said to somebody during this conference?

A. No; oh, no, not at this time. I was just saying, I was just commenting on my familiarity with the subject when it was presented to me in connection with searching the files.

Q. What did you tell Mr. Levine to do and what did you say at this meeting?

A. Here again I don't recall the exact language, but I said that we wanted to cooperate wholeheartedly and to give the Department of Justice anything that we could find in this area.

Q. Was there any written communication to you from the Department of Justice on the matter?

A. Not that I know of.

Q. Was there any suggestion as to how this information would be made available to the Department of Justice?

A. I think we were to hand them copies, I don't recall. As I understand it, we were to find these copies in our files on the subject and give them to the representatives of the Department of Justice. What they at this point —I think at that point I wasn't too sure what they were going to be used for, whether they were going to—I was familiar with the fact that we couldn't allow these to be disclosed to the public because of the names on the rulings.

Q. How long was it after this, what were your instructions specifically to Mr. Levine and the person from the Chief Counsel's Office?

A. I don't think I can be specific. I merely told Mr. Levine to go ahead with the search.

Q. Did you specify how he was to do this?

A. Not particularly, no, I don't think I specified how the search should be made. Mr. Levine was an employee, and knew where the files were.

Q. When did you next discuss this subject with anyone in the Department of Justice?

A. I think there were several discussions or several communications with Mr. Levine and—

Q. Were these oral or written?

A. These were oral, these were oral discussions. Mr. Levine from time to time as they found the copies would merely advise me of the copies that he had found.

Q. What was the scope of this search, was it to cover all of the files of the Internal Revenue Service from the beginning of time or was there any time limitation?

A. Insofar as I was concerned, no. It was just to find all the rulings we could within reason, find all the rulings we could in our existing files with respect to this issue.

Q. About how many times did you meet with Mr. Levine before you next met with the representative of the Department of Justice?

First of all, did you have any further conferences with the representative of the Department of Justice?

A. Yes, I think there were several discussions later on with respect primarily to how to present the rulings or what we could use in the rulings, what had to be cut out. I wasn't too sure what was to be done with the rulings. It was my understanding that we were merely to get these rulings out and furnish them to the Department of Justice.

Q. There has been a prior reference here to an affidavit executed by you.

A. I think I have a copy of it.

Q. Would you just describe the circumstances under which this affidavit was first suggested to you?

A. Yes. I believe, here again, as I remember, and again I don't remember the name of the man in the Department of Justice but a gentleman from the Department of Justice and Mr. Levine came into my office with a proposed copy of an affidavit and showed it to me, and I read it and then the thought was that we may ask you to make this affidavit.

Shortly thereafter then I did make it.

Q. What was the elapsed time between the time of the suggestion and the time of execution?

A. I think approximately two or three days.

Q. How did Mr. Levine report to you?

A. Orally.

Q. What was the substance of his report to you most immediately before the decision with respect to execution of an affidavit?

A. He reported to me that primarily he had discovered these rulings. As they found them he would informally come down and say, "We have located another ruling" and he would show it to me. I think he told me at this time they were from the files that they had found in the experts' offices and the conferences, that they had also searched the Precedent Files and the general files, to get the regular files out and the carbon copies that they had located.

Q. Were these files left with you?

A. Carbon copies of the letters were left with me at that time, but I had them for a while to look at, yes.

Q. What else did you do?

A. At various times I had all of this material, I think, that's been discussed here.

Q. Specifically, did you have all of the exhibits, A, B, C, D, E, F and related matters before you, before your execution of your affidavit?

Mr. Duncan: Counsel, I seriously object to this. We have stipulated that we discovered one ruling after that. We stipulated this, that one ruling was found, the '51 ruling was found after.

Mr. Davis: I am asking Mr. Swartz, if counsel will just confine himself, this is certainly an area of interrogation in cross-examination as to on what the affidavit was based, and Mr. Swartz is best qualified to respond to that.

Mr. Duncan: Are you rescinding your agreement to the stipulation?

Mr. Davis: No.

Mr. Duncan: All right, then.

Go ahead, you can answer, Mr. Swartz.

The Witness: I don't recall whether I had all of the numbered exhibits, I don't believe that I did have at that time the exhibits that are numbered A, B and C, some of the requests with respect to the files.

By Mr. Davis:

Q. But you think you had all of the ruling letters; is that correct?

A. I don't know as I had all of them that were here. I think there were five or six at the time.

Q. Did you read all of the papers in each file before executing the affidavit?

A. I read the ruling letters.

Q. Just the ruling letters.

Do you know who prepared the affidavit?

A. No, I do not.

Q. Were there any changes made between—to your knowledge between the time it was first presented to you and the time you executed it?

A. Not that I recall. As I remember, the affidavit that I signed was at least substantially the same as the proposed copy. There may have been a change or two.

Q. You indicated that a search was to be made of "our existing files", Internal Revenue Service.

A. It had to be files that existed.

Q. Is there any limit to the duration of the period of time that these rulings were to cover as a terminal date beyond which the search would not go?

A. No, there was no time limit set. It was all rulings.

Q. And that's up to—

A. As far as I knew, as far as my knowledge is concerned.

Q. That's up to September 22, 1961?

A. At the time I signed this, yes.

Q. Did this search cover any other offices within the Internal Revenue Service than the Assistant Commissioner, Technical?

A. I don't believe so. I think the general files and the Precedent Files are located within the Technical Organization.

Q. Now, would you go into this Precedent File, just whose responsibility it is to determine whether a ruling is in the Precedent File category?

A. I'm really not sure. I think that these are digested. In other words, the author of the ruling is to determine whether or not this establishes a precedent, whether or not this is the first time this issue has been raised, or whether this is a variation of a precedent, whether a precedent has been established and whether it would be worth while being put in the file to which reference need be made by other people.

Obviously, the Precedent File, the purpose is to separate out the specific precedents on which other rulings are based so that the Precedent File doesn't contain these 30,000 rulings, on the precedents.

Q. Anything in the Precedent File then is the basis for issuance of rulings in other situations, is that correct?

A. They can be used, it indicates a precedent that has been set, a position that has been adopted and can be referred to as having been ruled on before.

Q. I see.

A. It's part of a research job. It's like researching, along with regulations, published rulings, we also research precedents set in the unpublished rulings.

Q. What is the relationship between the Precedent File procedure and the rulings policy of Internal Revenue Service?

A. It wasn't until 1954 that we adopted our present rulings policy. Prior to 1954, rulings, published rulings were made in some cases of matters that were put in the Precedent File, not all of them. Our policy with respect to publication of rulings prior to 1954 was that we would publish rulings of widespread interest in something that we thought would affect a lot of taxpayers.

I think we probably published 60, 70 or 80 rulings in those days whereas now we are publishing 5 or 600.

Mr. Duncan: Could I clarify that? Do you mean annually?

The Witness: Annually.

By Mr. Davis:

Q. Had there been a policy of Internal Revenue Service as announced to the public that no unpublished ruling would be applied in the disposition of any case, any other case?

A. No unpublished ruling?

Q. Yes. If you know, to your knowledge.

A. What time? I mean, this—is there any period of time that you are referring to?

Q. During the period from 1945 to 1951.

A. To '51.

Q. Yes.

A. Those unpublished rulings were not to be cited; that is, they weren't to be cited by name because of the disclosure policy.

These copies of rulings that were sent out to the field were just—had names of taxpayers on them, they weren't digested, they were copies of the actual rulings, and the Revenue Agents were warned not to cite those as being issued to taxpayers, because we were prevented from doing so by law. They obviously were to be used for reference purposes, otherwise they wouldn't have been sent to the field.

Q. Was there not an announced policy that no unpublished ruling would be relied upon in the disposition of any case?

A. I don't recall now, but I think probably the language in the Internal Revenue Bulletin was such that unpublished rulings should not be cited or relied upon.

Q. Is this cited?

A. Cited or relied upon. That ordinarily was to take care of the disclosure provision.

Q. What makes you think that it was only to take care of the disclosure provision?

A. This certainly was an assumption because the copies of rulings were sent out to the field offices and were relied on by Revenue Agents but not cited by Revenue Agents.

Q. Who made the decision for example in respect of the ruling—strike this question, please.

Do you know how the rulings which were not referred to, or which had not been discovered at the time of the execution of your affidavit were located?

A. Not precisely, no. Mr. Levine from time to time merely asked me or told me that they had located another.

Q. Do you base your opinion that there were no rulings issued contrary to the Exhibits A, B ,C, D, E, and F—

Mr. Duncan: 1 through 7.

Off the record.

(Discussion off the record.)

Mr. Duncan: Back on the record.

By Mr. Davis:

Q. Mr. Swartz, referring to Exhibits, Defendant's Exhibits 1, 2, 3, and 4, you have stated that there are no rulings—

A. 1 through 4.

Q. Yes. (Continuing) —no rulings contrary to those rulings issued at any time from 1944 on to December 31, 1950; is that correct?

A. I'm not sure of that. Would you restate the question, please?

Q. Yes, sir.

First of all, let's refer to them one at a time.

Referring to Exhibit 1, this is a letter ruling dated February 14, 1944.

A. Yes.

Q. You have stated that there was no likelihood, no probability of the issuance of a contrary ruling.

A. I think what I stated was that it was unlikely that there were any contrary rulings issued holding that an affiliate could not file consolidated returns where a parent was on the fiscal year basis and an insurance company was on a calendar year basis, provided they followed the instructions in the ruling contained in our rulings.

For example, I think the Exhibit 1 ruling held that an insurance company—held that an insurance company could not shift to a fiscal year in order to file consolidated returns. I don't think there is anything that has been issued contrary to that particular letter insofar as the filing year is concerned.

Q. Does the ruling stand for anything else, beyond what you have just stated?

A. Does that particular ruling stand for anything else?

Q. Yes.

Mr. Duncan: Take your time, Mr. Swartz.

The Witness: (Consulting exhibit) In this particular case I think a ruling had been issued granting consolidated returns on a fiscal year basis, and this ruling was to tell them that that ruling was erroneous, that this could no longer be accepted and that therefore we revoked the previous ruling which was dated December 11, 1941 and held that they had to file their returns on a calendar year basis after that date.

But if a consolidated group obtained permission to change to the calendar year basis, that a consolidated return would be required for the month of December 1944, and also in the event that the remainder of the group elected to file on a fiscal year basis, the company would be required to file a separate return for the month of December in order to again place them on a calendar year basis.

Mr. Davis: Would you please repeat my question.

(The question was read by the reporter.)

The Witness: Well, the ruling stands for what is contained in the ruling letter; in the ruling letter we said that under the Income Tax Regulations an insurance company had to file their returns on a calendar year basis, and therefore permission should not have been granted to change to a fiscal year basis.

By Mr. Davis:

Q. Do you have this file here with you, the file containing the original carbon of Defendant's Exhibit No. 1?

(A folder was handed to the witness by counsel for Defendant.)

Mr. Duncan: Answer the question.

The Witness: Yes.

By Mr. Davis:

Q. Would you indicate what is the writing on the cover of this folder? So that it can be identified.

A. This is identified as a file of the Practice and Procedure Division of the Bureau of Information and Rulings Section, the Income Tax Unit.

Mr. Duncan: Let the record also show that the file contains the name of the taxpayer to whom the ruling was issued.

Mr. Davis: I have no objection.

By Mr. Davis:

Q. Would you describe the first document which appears in this file?

A. The first document?

Q. Yes, that is the first—if there are pages attached to either side of the file, would you give the pages—

A. On the lefthand side of the file is stapled a document called A Rulings Publication and Distribution Memorandum. This is a memorandum which is prepared, I guess, usually by the originator of the ruling as to whether or not this ruling should be submitted for publication.

Q. Is there a recommendation as to publication, sir?

A. Yes, the recommendation is no.

Q. Is there any indication why?

A. Yes, the reason is that calendar years are required for insurance companies, the accounting period is the same as the parent, and that the ruling is based on administrative expediency which is served in handling this case.

Q. Is this the comment with respect to the letter dated February 14, 1944, marked Defendant's Exhibit No. 1?

A. This has to do with—this is, actually this refers to, the digest reference is to a date of a communication to the Internal Revenue Agent in Charge in Chicago, inasmuch as this was in response to their question as to whether or not our original ruling was correct, a request for technical advice in connection with this particular tax letter.

Q. What is the second paper on the lefthand side of the folder?

A. That is all.

Q. I see. All right, then, beginning with the first paper, perhaps next to the bottom.

A. Starting at the bottom—

Q. Will you excuse me, please. Was what you said about what is on the first paper, the exact words that are written there?

A. Well, it's in digest form. I'll repeat what's written there, if you would like me to.

The question is: "Should ruling be submitted for publication?" The answer is "No". It goes on to say: "If not, state reasons". The reasons stated are: "Calendar year required for insurance companies, Section 29.204-1 Reg. 111."

The next line is: "Accounting period same as parent, Section 24-14, Reg. 104".

The next sentence is: "Balance of ruling, administrative expediency suited to this particular case".

Q. The first document on the righthand side of the file at the bottom?

Mr. Duncan: On the bottom.

The Witness: Are these all right?

Mr. Duncan: Yes, tell him what they are.

The Witness: The first document is a memorandum commonly designated as a GCM, General Counsel's Memorandum, addressed to the Deputy Commissioner of the Income Tax Unit from the Chief Counsel of the Bureau of Internal Revenue.

By Mr. Davis:

Q. What is the date?

A. The date is February 1, 1944.

Q. All right. What is the next document?

A. The next item is merely a transmittal form, I guess this—it's a transmittal form regarding this taxpayer to the Head of the Practice and Procedure Division to the attention of the Information and Ruling Section.

Q. What does it transmit?

A. It transmits, this says there are enclosed in accordance with paragraph 832 of the Income Tax Manual two carbon copies of a letter addressed to the Internal Revenue Agent under date of March 7, 1944 in response to an inquiry made under paragraph 630 of the Internal Revenue Agent's Manual.

The next document is a ruling letter dated February 14, 1944 to a taxpayer in response to a request for a ruling dated December 11, 1941, signed by the Deputy Commissioner of the Income Tax Unit.

Q. Is this a copy of the document offered in evidence here over objection of the plaintiff, Defendant's Exhibit 1?

A. Yes.

Q. What is the next item?

A. The next item is a memorandum or letter dated March 7, 1944, to the Internal Revenue Agent in Charge, Chicago, Illinois, signed by the Deputy Commissioner of the Income Tax Unit.

Q. What is the next one?

A. The next one is a digest for the subject file. This is a digest which is made for the subject file, the Precedent File, outlining in digest form what the ruling contains that is to be digested.

Q. The file does not contain the letter dated December 11, 1941 addressed to the Collector of Internal Revenue?

A. This is all that's in the file; it does not contain the letter, no.

Q. In the usual course, where would such a letter be?

A. This apparently was a letter, the letter of December 11, 1941 referred to was addressed to the Collector of Internal Revenue at Detroit, and the Collector furnished a copy of that ruling to this taxpayer for his files. The letter of December 11, 1941 apparently was at the request

of the Collector of Internal Revenue with regard to a request addressed to the Collector by the taxpayer, so apparently the Collector would have this file. We referred to a letter addressed to the Collector at Detroit, a copy of which was furnished for your files, "Your files" being the taxpayer.

Q. This digest of the letter ruling, what is the substance of that?

A. After digesting—

Q. Would you care to read it?

A. If there is no taxpayer.

Mr. Duncan: Let's look at it. It is somewhat lengthy. There is nothing, no problem in it, but I don't want to take up Mr. Swartz' time. I do suppose we could get a—well, why don't you read it, it isn't too lengthy. Leave out the taxpayer's name.

The Witness: Leaving out the taxpayer's name, this says:

Blank in substitution for the taxpayer's name "(100 per cent subsidiary of" blank "corporation) is a stock casualty insurance company, taxable under Section 204 of the Internal Revenue Code. It filed income tax returns on the calendar year basis for 1939 and 1940, but in order to join with its parent (which files its returns on the basis of a fiscal year ending November 30), it secured permission under date of December 11, 1941 to change to the fiscal year effective for the period ending November 30, 1941. As insurance companies taxable under Section 204 of the Code are required to report on the calendar year basis, the permission to change accounting period was revoked by letter of February 14, 1944. Held, in view of the fact that consolidated returns were filed pursuant to authority granted, consolidated returns will be accepted for

taxable years ended November 30, 1941, 1942, 1943 and the taxable year ending November 30, 1944. Subsequent to November 30, 1944 consolidated returns will not be accepted unless such returns are filed on the calendar year basis. If the consolidated group wishes to change to the calendar year basis, effective as of December 31, 1944, application should be filed by the parent company in accordance with Section 29.46-1 Regulation 111. In the event that the group does not desire to file a consolidated return on the calendar year basis for 1945 and subsequent years, the members thereof will be permitted to file separate returns.''

Q. Thank you.

What was the nature of the letter to the Internal Revenue Agent in Charge?

A. It makes reference to their letter in which technical advice is requested under paragraph 630 of the Internal Revenue Agent's Manual relative to issues arising in the case of this taxpayer for the taxable year 1941.

This is a full page letter, it—how detailed do you want this? It goes into the facts as described with respect to the years they were on. The Internal Revenue Agent in Charge apparently invites the attention of the Washington Office to the provisions of the Section 19.204(a)1 of the regulations stating that it appears to be apparent or it is apparent that the taxable year of this type of insurance company covered by Section 204 can be only a calendar year, and that the use of a fiscal year is not—is irreconcilable with the regulations.

It asks that our ruling granting permission to the taxpayer to change its accounting period from a calendar year to a fiscal year basis be reconsidered.

Q. By whom is that ruling issued in the original ruling?

A. This one I'm reading from?

Q. No, the ruling granting—

A. The original ruling?

Q. Yes. Is that apparent from the file?

A. We don't have a copy of the December 11, 1941 ruling. Is this the one you're referring to?

Q. Yes.

A. This is the one that—apparently what happened here was December 11, 1941 a letter was issued from the Washington office to the Collector of Internal Revenue in Detroit granting the taxpayer permission to file on a fiscal year basis.

Q. Yes. Now my question is where would that letter be?

A. That letter apparently was contained in the Collector's file.

Q. But would not a copy be here in the Washington Headquarters?

A. Ordinarily I guess it would. This file starts out in 1944, this particular file starts out with a February 1, 1944 document.

Q. Would there have been another file in the name of this taxpayer?

A. No, this is the file that has this taxpayer's name on it. I can't say that there wouldn't have been another file prior to 1944; I don't know.

Q. But who would have had the authority to issue a letter granting the consent to file a consolidated return on a fiscal year at that time?

A. In 1941 it would have been the Deputy Commissioner of the Income Tax Unit, or someone under him who might have authority to grant such permission. I don't know what the delegations of authority, what delegations of authority there were in 1941.

Q. Do you know whether, from your knowledge, the search of Mr. Levine did not disclose the file which contains this ruling letter dated December 11, 1941?

A. I assume that his search did not locate any such letter. We didn't discuss—I don't recall discussing it particularly, this particular letter.

Q. No instructions from you would have authorized him to fail to search for such a letter so it could have been found?

A. There was nothing that authorized him not to search for one, no.

Q. Then your instructions were that he was to have searched for all of them.

A. All that could be located in their files.

Q. Referring now to Exhibit No. 2, Defendant's Exhibit No. 2 offered in evidence over the objection of or subject to the objection of the Plaintiff—before proceeding with Exhibit No. 2, is there anything in the file which shows how it happened to get into the Precedent File?

Mr. Duncan: You're referring to the ruling letter of February 14, 1944?

Mr. Davis: Yes.

The Witness: How this got into the—

By Mr. Davis:

Q. How the ruling letter dated February 14, 1944 got into the Precedent File.

Mr. Rothe: Defendant's Exhibit No. 1.

The Witness: There is nothing—yes, in this document entitled Ruling Publication and Distribution Memo, one of the questions is "Should ruling be digested?" and the answer is "yes".

Q. What is the significance of that?

A. The significance is, I guess, that the ruling is important, was important enough to be placed in the Precedent File, digested and placed in the Precedent File, for future use.

Q. But the same document says not important enough to be published, in effect?

A. That's right, bearing in mind that our publication policy at that time was to publish rulings of a nature that would cover widespread interest, because there were quite a lot of rulings that were digested at that time that were placed in the Precedent File and even circulated to the field that were not published.

Q. Do you know when this practice began?

A. Which practice?

Q. The Precedent file.

A. No, sir, I do not. It was in existence when I came to Washington in 1943, and it must have been in existence considerably, a long time before that—at least, I am not so sure about the Precedent File, but insofar as circulating copies of these rulings to the field, we had them in the New York Office prior to that date.

Q. Now, to Exhibit No. 2, you indicated that you came to Washington in 1943; is that correct?

A. I came to Washington on detail in 1943 in connection with pension trust issues.

Q. Yes.

A. And was transferred to Washington in 1945.

Q. So that you have not had anything to do with the consideration of the problem which resulted in the issuance of Defendant's Exhibit No. 1?

A. No, sir.

Q. In regard to Defendant's Exhibit No. 2, did you have anything to do with the consideration of the problems which led to the issuance of that?

A. No, sir.

Q. Any opinion which you have as to what this ruling prescribes or determines as a position of the Internal Revenue Service is based upon simply your reading of the ruling; is that correct?

A. That's right.

Q. What do you think this ruling, Exhibit No. 2, stands for?

A. This is a request from a taxpayer whose—from an affiliate whose parent was on a fiscal year ending June 30, '45 in this particular case. It has acquired an insurance company on July, somewhere around July 1st 1945 and it asks the question as to how under those circumstances they could file consolidated returns.

The answer holds that if the corporation was to secure permission to change to a calendar year basis effective December 31st '45, and if the insurance company involved became a member of the affiliated group during the month of July, consolidated returns could be filed for the taxable period July 1st '45 to December 31st '45.

Q. Isn't it true that this problem invoives only the acquisition of an insurance company subsidiary after the start of the parent's fiscal year?

A. This particular ruling was based on an insurance company acquired after the end of the parent's fiscal year.

Q. Is it also true that there is nothing whatsoever in the ruling relating to the mechanics of conforming accounting periods where the companies are already affiliated as was true in the ruling in Exhibit No. 1?

A. It set forth how consolidated returns could be filed, if they secured permission to change their accounting period. Maybe I didn't understand your question.

Q. Does the ruling set forth in the document offered here as Defendant's Exhibit No. 1 relate as to the question of whether and how taxpayers already affiliated might conceivably file an amended or file a consolidated return?

A. Already affiliated?

Q. Yes.

A. No; apparently this has to do with an affiliation with respect to an insurance company that was acquired after the fiscal year of the parent.

Q. Do you perceive any reasons why the difference in facts might be significant?

A. Between Exhibit 1 and Exhibit 2?

Q. Yes.

A. Exhibit 1 had to do with whether or not an insurance company could file on a fiscal year basis. The question here is how to file consolidated returns in connection with an insurance company acquired after the date of the fiscal year of the parent.

Mr. Rothe: The beginning date of the fiscal year?

The Witness: This, as I understand it—that they would acquire an insurance company between July 1st and July 30th. They acquired an amount of stock of the insurance company but it would be after, certainly after June 30th 1945.

By Mr. Davis:

Q. This would be after the beginning of the fiscal year of the parent in that case?

A. On or after.

Q. I believe you testified that this ruling appears in the Precedent File?

A. Yes.

Q. Is there anything to indicate why that ruling was selected for the Precedent File?

A. Nothing in the file other than in answer to the question: "Should the ruling be digested?", the answer is "Yes".

Q. That is all that appears?

A. That's all that appears, that is all that is indicated in the file as to why.

Q. Do you see any reason why it should have been digested. What would it add to the Precedent File that was not provided by the first ruling, in your opinion?

A. I don't know, but apparently the people at the time thought it was important enough to digest and also important enough to distribute to the field.

Q. If it were to be distributed to the field, would it be relied upon by the field people, presumably, in the disposition of other cases?

A. As I testified before, the distribution of these rulings to the field were, of course, not to be cited because of the violating of the rules of disclosure, but they were placed in the files of the various Internal Revenue Agents in Charge office by Revenue Agents having similar problems. This was the way they were utilized in the field.

Q. Would you take us through this file now in the same way that you did the file relating to Defendant's Exhibit No. 1, first the lefthand side.

A. On the left side of the folder is a similar document entitled "Ruling Publication and Distribution Memorandum".

The question: "Should ruling be digested?" The answer is "Yes".

"Should ruling be submitted for publication?" The answer is "No".

Reasons for nonpublication as follows: "Sufficiently covered by the regulation, relates to a proposed transaction, an if ruling based on an assumption".

"Should ruling be distributed?" There was an answer "No" put in there and then crossed out and answered, "Distribute" with the initials of the man who apparently had charge at that time of distribution. It's F.K.S., I believe, that was Fred Slanker at that time. He was in charge of the publication-distribution section, or whatever section it was.

Q. Is there anything else on that page?

A. Nothing but initials.

Q. All right.

Going to that particular file on the righthand side.

A. On the righthand side is a request for a ruling dated April 17, 1945 addressed to Deputy Commissioner of the Inocme Tax Unit—

Mr. Rothe: The same as Defendant's Exhibit 2-A?

Mr. Duncan: Is that the same as Defendant's Exhibit 2-A?

The Witness: That's the same as, yes, the same as Exhibit 2-A.

The next document is a copy of the ruling letter dated May 26, 1945 which is the same as Exhibit 2.

The next document is the digest for the subject file, would you like me to read that?

By Mr. Davis:

Q. Yes, please.

A. Here again, I am substituting "blank" for the name of the taxpayer.

Blank "and it's subsidiary filed consolidated income and excess profits tax returns on the basis of a fiscal year ending June 30. It is proposed that "blank" will between July 1st and July 30th 1945 acquire sufficient stock in an insurance company which is taxable under Section 204 of the Internal Revenue Code, as amended, to qualify as a member of the affiliated group. The insurance company files returns on a calendar year basis as required by Section 29.204-1 of Regulations 111. Held, the insurance company would not be permitted to report its income on the basis of a fiscal year ending June 30th for the purpose of joining in the filing of a consolidated return. Held further, if "blank" "and its subsidiaries secure permission and change their accounting periods to a calendar year

basis effective December 31, 1945 and if the insurance company becomes a member of the affiliated group between July 1st and July 30th 1945, consolidated returns may be filed for the taxable period July 1st 1945 to December 31st 1945. The insurance company will be required to file a separate return for the period in 1945 with respect to which its income is not included in the consolidated returns.''

I don't know whether, is this part of the file? (Consulting with counsel).

Mr. Duncan: I don't believe it is, but you can refer to it, if you will.

The Witness: In this file, whether or not it was part of this file originally, in this file is a mimeographed copy of the ruling dated May 26, '45 which is Exhibit 2. It's headed ''Confidential Unpublished Ruling No. 1661''.

By Mr. Davis:

Q. Mr. Swartz, referring to Defendant's Exhibit No. 2, the second page, thereon is contained a set of initials, various sets of initials. The first one in the lower left is an initial, set of initials E.C.H. 5/4/45, and on the right-hand side, far right are 5/26/45.

This would indicate that between these two dates various people examined this proposed ruling letter and presumably read it sufficiently to decide whether or not to affix their initials.

Would you describe just how that might have been accomplished?

A. Quite often—I don't know how it was accomplished particularly in this particular ruling. Quite often, insofar as the dates are concerned on the ruling, it may be that this issue had been discussed by the people who initialed, and where the issue may have been discussed with the people who initialed sometimes if a decision had been made in conference or as a result of a discussion, when

the final ruling is finally prepared and they recognize what the issue is as having been discussed the initials flow through pretty fast. I have no reason to believe this happened here, but sometimes this happens.

Q. Who would have prepared the original or the draft of the original, the person bearing the initials E.C.H.?

A. Yes, ordinarily the first initial is the author. This is not necessarily—this does not necessarily mean that he drafted originally the letter that was finally issued. It's possible that this letter may have been drafted before this May 4, '45 date. It may have gone through several initials and then somebody might have wanted some changes in this letter, at which time it may have been re-drafted by the originator in accordance with the suggested changes along the line, so this could really very well be the combined efforts of everyone here.

Q. How would the draft as prepared by the one who initiated the letter or who considered the request for ruling initially, how would it be communicated, transmitted from person to person among the people listed here?

A. I presume ordinarily by the regular routing at that time. In 1945, I am not too sure how those were handled. Sometimes, I presume, within the group it may have been handed to the next reviewer where they were on the same floor. In other cases, of course, it goes into the routine transmittal by messenger, where a messenger would pick it up and take it to the next office.

Q. Yes.

Now, you have indicated, I believe, that there was something about this exhibit 2, or suggested that it had been transmitted to the Office of the Chief Counsel for review; is that correct?

Mr. Duncan: I believe the testimony was with respect to Exhibit 4, but this may well have been too. I may be wrong on that.

By Mr. Davis:

Q. Is there anything to indicate, are the initials J.P.W. there indicative of a review by the Chief Counsel?

A. I would assume that the initials J.P.W. are the initials of Mr. Wenchel who at that time was Chief Counsel.

Q. Would a proposed ruling such as this have been delivered to Mr. Wenchel for his coordination without some communication of transmittal?

A. In those days I don't know what the procedure was. In some cases the ruling letter is merely, merely sent up with what was called a "buck slip" for their initials or disapproval. Not all of the submissions to the Chief Counsel are accompanied by a covering memorandum. Quite often the ruling letter is merely sent up there for approval.

Q. Are there any—to your knowledge, Mr. Swartz, are there any other files in your office relating to the issuance of this particular ruling letter, Exhibit No. 2, which is not in the file which is now in your hands?

A. In my office?

Q. In the office of the Assistant Commissioner, Technical?

A. Not that I know of. I don't know. I have the file here. This is all that is contained in this file and I am unaware of—

Q. Are there any auxiliary or related files bearing upon the issuance of this letter of ruling in the Internal Revenue Service?

A. There may be. There may be files in the Chief Counsel's Office, that I don't know.

Mr. Rothe: I think the record should show that just a moment ago Mr. Levine pointed to a file which was in front of him and indicated that file to Mr. Wilson.

Just let the record show that, please.

Mr. Duncan: We are not hiding the fact that there are other files.

Mr. Wilson: I have no objection.

Mr. Rothe: Just let the record it, that's all.

Mr. Duncan: But as far as Mr. Swartz' office goes, I think his testimony is clear. He has testified with respect to the files from his office.

By Mr. Davis:

Q. That there are no files in the office of Assistant Commissioner, Technical—

Mr. Duncan: In the custody of Assistant Commissioner, Technical's office, yes.

By Mr. Davis:

Q. To your knowledge, Mr. Swartz, are there files in the custody of any officer of the Internal Revenue Service or of the Treasury Department relating to the issuance of this ruling which are not included in what you have before you?

A. To my knowledge, I don't—I am unaware of files in any other office. I presume that ordinarily there might be a copy or something, I imagine, in the Chief Counsel's Office to record that they had reviewed this document. If there was any interoffice comment or anything like that, it might appear in the files of the Chief Counsel.

Q. If there was an interoffice comment, would that not have been addressed to you?

A. If it were—by interoffice I meant in the office of the Chief Counsel, not being communicated to me.

Q. I see.

Do you know or can you testify that there was no communication, no written communication addressed to you by the office of the Chief Counsel addressed to the Assistant Commissioner, or the Acting Commissioner in this case by the Office of Chief Counsel relative to the issuance of ruling designated as Exhibit No. 2?

A. I can answer it this way, that had there been a communication from the Chief Counsel to the Office of the Deputy Commissioner I presume it would be in this file with respect to this particular case.

Q. Do you know whether Mr. Levine made a search for any such files in the Office of Chief Counsel?

A. I do not know it of my own knowledge. He was to make a search of my office and any documents that we might have pertaining to this issue.

Q. Did he make it; to your knowledge, did he make a search beyond the files in your own office?

A. Not to my knowledge.

Q. Would I be correct in identifying the initials E.C.H. as being Mr. Heft, Earl Heft?

A. I think that's probably right, yes.

Mr. Rothe: H-e-f-t.

The Witness: H-e-f-t.

By Mr. Davis:

Q. What is the next item in the file?

Mr. Duncan: I think you have identified them all.

The Witness: This is all in this file.

By Mr. Davis:

Q. Thank you.

You referred to an index card that listed the issue in the ruling in Exhibit No. 2, and I believe you stated in the distribution in the field just what the issue was?

A. The document that went to the field is merely a copy of the ruling letter that was issued to the taxpayer, plus, in addition, at the bottom of the—following the ruling letter is a digest which, as far as I can see, is identical with the digest, however, just for the subject file.

Q. I see.

What is the document called from which you have just read?

A. This one?

Q. To which you have just referred rather.

A. The one that's circulated to the field?

Q. Yes.

A. I think I identified it as "Confidential Unpublished Ruling No. 1661".

Q. Would you describe generally what this classification of document entails?

A. The classification?

Q. What is covered by the term "Confidential Unpublished"?

A. A Confidential Unpublished Ruling is a document which is circulated to the field which is not to be cited by name as being—inasmuch as it contains the name of the taxpayer, that it is confidential to that extent and that the ruling contained therein has not been published, at least at the time the document was issued.

Q. You made reference to the problem of avoiding divulgence of the identity of the taxpayer. What do you know about the policy or the origin of the policy of Internal Revenue Service as set forth in the Internal Revenue Bulletin that no unpublished ruling will be relied upon in the disposition of any other case?

A. I was not—I did not participate in drafting that part of the Internal Revenue Bulletin—

Q. No.

A. —that states that.

Q. On what do you base your conclusion, then, that it is because of the identification problem in maintaining, or avoiding divulgence of any identification?

A. I base that on the fact that when I was a Revenue Agent in the field, in New York that these C.U.R.s, as we called them, Confidential Unpublished Rulings, were put in the files and available to the Revenue Agents to be used so long as they were not cited.

Q. Who told you that this was—

A. It was probably my group chief or the persons in the New York Office who broke me in as a Revenue Agent and told me where the files were located and what materials were available to us in order to conduct an examination.

Q. I see.

You, of course, are familiar with the provision in the Internal Revenue Bulletin, and I quote, "No unpublished ruling or decision will be cited or relied upon by any officer or employee of the Bureau of Internal Revenue as a precedent in the disposition of other cases".

A. Yes, sir.

Q. And you think, or you have reason to believe that this statement is limited solely to maintenance of the identity, preservation of the identity of the taxpayer in the particular case?

A. I can answer that by saying how I was informed they were to be utilized, and that was we weren't to cite them. In other words, for purposes of our reports to, with respect to audits to taxpayers, we could cite only the law, the regulations or published rulings or supreme court cases. We were not to cite or to rely on those decisions for purposes of quoting or putting in statutory notices or the reasoning in our audit reports. However, they were in the open files and available to be utilized to look at the reasoning on the disposition of the issues, in order for us to dispose of the issues if they came before us. We did not, however, cite them, nor did we rely on them insofar as quoting them for purposes of the decision we made in connection with the auditing required, but they were helpful for reference purposes that that issue had been considered by the officers in Washington who had arrived at a policy decision and felt sufficient enough that this was important enough a decision to be circulated to the field,

but should not be cited nor should we rely on it for the purposes of quoting it in our—for example, we were instructed not to rely on paragraphs contained in material, in training material, for example. There was a good deal of training material, and we were not to rely on nor cite anything in disposing of our cases with respect to anything that was contained in the training material.

But we nevertheless used those for purposes of research in connection with trying to find a satisfactory answer to any question that arose in connection with an audited return.

Q. To the best of your knowledge, did any of these Exhibits 1 through 7 ever become available, were they ever delivered either in copy form or any other manner to any person outside the Internal Revenue Service, except the addressee?

Mr. Duncan: I'll object to that question, unless you limit it to delivery by representatives of the Internal Revenue Service. He can't have knowledge as to what a taxpayer might do with a ruling.

By Mr. Davis:

Q. Delivered by anyone of the Internal Revenue Service?

A. I have no knowledge, of course, that someone did not deliver, but the orders, of course, were, the rules are, of course, that they are not to be shown or delivered to anyone else other than the taxpayer.

Q. Would you refer to the file containing Exhibit No. 3.

A. This is Exhibit No. 3. Now, we have—as far as I know, we have been unable to locate this file, the file on this particular one.

Q. Do you know what search has been made for it?

A. The same search, I guess, that was made with respect to the others.

Q. Just what search was made, what has Mr. Levine told you as to what he did with respect to the location of this file?

A. Mr. Levine told me he exhausted all ways and means of locating all correspondence with respect to this particular issue.

Q. Do you know whether he made the search himself or whether he delegated it to someone else?

A. I do not know. I know that he said to me that he had found this or he had found that. I imagine that there was more than one person doing the search; I'm not sure, of my own knowledge I do not know.

Q. This is a ruling letter which you do not know for sure was in the Precedent File or was not in the Precedent File? It may or may not have been?

A. I don't believe this could have been in the Precedent File.

Q. Do you know where it was found?

A. I assume this may be one of the—I don't know for sure, but I assume this may be one of the letters from the files of one of the experts in the Corporation Branch, but I'm not sure. I assume it was.

Q. Is it possible that there may be files of former experts of the branch with rulings like this one?

A. Well, anything is possible. Ordinarily, though, when someone takes over the desk of that particular expert, it's because this particular expert is retiring or going to some other branch and the personal files or any files that happen to be on that particular subject are usually retained by the person taking over that particular desk.

Q. Do you know where Mr. Heft is now employed?

A. I understand Mr. Heft is employed by General Motors, the last I heard.

Q. Is this letter—I can't really make out whose initials are on it.

A. The initials up at the top are apparently E.C.H. Yes, that would be Earl Heft at the top of the letter.

Q. Where is he employed in General Motors? Do you know?

A. I don't know. I understand he's employed in the tax department somewhere. I understand he has something to do with preparing the returns or seeing that the returns are filed properly.

Q. Over the years from 1944 to the present time, how many people have been employed in the capacity which you would consider that of an expert in the field of consolidated returns?

A. We had some experts on consolidated returns that came into the division that weren't necessarily working on consolidated returns, but I understand between 1944—let's see, and the present time there have been about six people that have worked on this particular subject, in the Rulings Division or in the old Coordinating and Advisory.

Q. Would you name them?

A. As I understand it there was Earl Heft, Dan Ferris, Carey Ross, David Deutsch, Howard Bradley and Driscoll, a man by the name of Driscoll. (After consulting with aides) His name was Ray Driscoll.

Q. During your service in the Tax Rulings Division, did you consider yourself an expert in the field of consolidated returns?

A. No, I can't say that I considered myself an expert on consolidated returns. I had occasion, of course, to go into consolidated questions, but I wouldn't have considered myself what we call a specialist on consolidated returns.

Q. Referring to Exhibit 4, before we go into Exhibit 4, Mr. Swartz, how do you explain the inability to locate the file relating to Exhibit 3? What do you think?

A. I have no explanation.

Q. Is this a frequent occurrence?

A. No, It isn't. Normally, if we have the name of the taxpayer, we can locate the file.

Q. If you do not have the name of the taxpayer and if the ruling has not been indexed in connection with the Precedent File process, then how would you locate a ruling relating to a given subject matter?

A. Which is not in the Precedent File?

Q. Yes.

A. That would have to be done in the general files under a broad index.

Q. What is the—

A. I think the broad index here would be "Consolidated Returns".

Q. There is no finer breakdown beyond that in the general file, "Consolidated Returns"?

A. As far as I know.

Q. Do you have any idea how many rulings have been issued since 1944 relating to Consolidated Returns?

A. I have no idea of the number, I don't think we have any breakdown on the number. There is a considerable number of rulings that have been issued in the consolidated area since 1944.

Q. Do you know whether all of those files were reviewed by Mr. Levine?

A. Oh, I think it would have been physically impossible for all of the material in all of those files to be physically reviewed. I have no knowledge that Mr. Levine didn't go through all those file, but it is quite a number dealing with all areas of consolidated returns.

Q. In order to make sure, though, that there were no other rulings issued than the ones set forth as Exhibits, 1 through 7 inclusive, it would be necessary to go through all of the consolidated returns files.

A. I presume, to make sure. On the other hand, as I say, the specialists kept copies of all of the rulings that are issued in our particular field and therefore it would not be too probable that there were any rulings that wouldn't be in the files and maintained by the files of the experts, although I couldn't say that not one of them got lost.

Q. Do you know who presently has the files that were in the custody of Mr. Heft when he was a specialist here in the service?

A. No, I do not, the particular individual that would have those files. You mean his personal files?

Q. His personal specialist files?

A. He was at one time Chief of the Branch and had custody of the corporation files, I mean, as such.

Q. No, I meant you referred to the fact that each specialist developed his own file and I was just wondering if you knew who had his files and how the custody was transferred?

A. No, I really don't know. I would assume that probably Mr. Bradley, Mr. Driscoll or Mr. Deutsch might have them. They are the ones, the last ones who worked on these.

Mr. Duncan: Off the record for a minute.

(Discussion off the record.)

Mr. Duncan: Back on the record.

By Mr. Davis:

Q. Now, to Exhibit 4, Mr. Swartz. Would you take us through that file, please?

A. Yes. On the lefthand side of the folder again is a document entitled "Ruling Publication and Distribution Memorandum". The question asked: "Should this ruling be digested?" The Answer is "Yes". The answer to the question "Should ruling be submitted for publication?" is "No". The reasons for nonpublication are as follows: "Partly covered by citations listed above; relates

to a proposed transaction; in part an 'if' ruling; changes in accounting are not ordinarily subject'' of application for publication—well it doesn't say application, ''of publication.''

In answer to the question ''Should ruling be distributed?'' the answer is ''No''. If not distributed state reasons ''See above reasons, except last; compare CUR 1661, which has been referred to before''—I don't know what that word is.

Mr. Duncan: Slight variation.

The Witness: (Continuing) ''the slight variation of facts from CUR 1661 not sufficient to require distribution.'' ''Principle is the same.''

On the righthand side of the folder—

By Mr. Davis:

Q. Before you go on, would you refer to the citations which are the basis for the decision against publication?

A. ''Partly covered by citations listed above'' on this document are citations with respect to the sections of the regulations involved. In this particular document it refers to Section 29.204-1 of Regulations 111, Section 23.13 -G and 23.14 and 23.32 of Regulations 104, Sections 33.14 and 33.32 of Regulations 110.

I might say there is another question here that is answered in this document. It says: ''Does ruling modify or revoke any published rulings or CURs?'' and the answer is ''No''.

Q. To you perceive any difference yourself as you have read this ruling, as I understand, between this one and the CUR?

A. No, this ruling and the ruling of May 26, 1945?

Q. Yes, that's the CUR.

A. This is the one that we were—in which the insurance company was acquired after the end of the fiscal year of the parent—

Mr. Duncan: After?

The Witness: We're talking about Exhibit 4?

Mr. Duncan: Yes.

Mr. Davis: Yes, Exhibit 4.

Mr. Duncan: As compared to Exhibit 2?

Mr. Davis: Yes.

Mr. Duncan: Take your time, Mr. Swartz, and read the difference.

The Witness: In the Exhibit No. 2—oh, Exhibit No. 2, the insurance company was apparently acquired after the end of the fiscal year of the parent, while in Exhibit No. 4 the insurance company was acquired before the end of the fiscal year of the parent.

By Mr. Davis:

Q. Now, reference was made to Exhibit 4-B—excuse me, this is probably going to be shorter to go through the file in your usual way.

A. All right.

Q. There is nothing else on the left side of the file?

A. Nothing else on the left side. Well, there is a card here. This is apparently just a card that is made out in connection with this other document as to whether or not this should be filed or should be made—put in a subject file.

There is a checkmark relating to issue, ''no ruling thereon in the subject file'' and it's checked and signed by E. C. Heft, the writer of the document.

Q. Would you repeat that? Do I understand that this writer, the writer of this card says there is no ruling thereon in the subject file?

A. Apparently with respect to the question as to whether this should be sent to the subject file or digested, the document here, which has various checkmarks on it; whether it distinguishes, modifies, revokes, affirms.

Q. What do those checks show?

A. There is nothing marked in that, in those checkmarks. This is apparently an information document with respect to the attached ruling as to whether it is recommended for inclusion in the subject file for the reasons that, and then: "interprets, distinguishes, modifies, revokes, or affirms". There is no checkmark in there.

Then it goes on to say, apparently, what does it distinguish or interpret, a published ruling, a distributed ruling, CUR, or another ruling in the subject file? And it says, "Relates to a new issue, no ruling thereon in subject file".

Mr. Duncan: Perhaps you ought to state for the record that that particular statement is checked.

The Witness: Yes.

Mr. Duncan: And who is the document signed by?

The Witness: It's signed by E. C. Heft, and approved by his reviewer, Mr. Olmstead.

By Mr. Davis:

Q. Is there anything to show why?

A. No, there's nothing on here except a checkmark in that one box and the two signatures.

Q. Did Mr. Heft prepare the preceding page, or is that apparent?

A. Apparently not. The initials here are M.M.S., approved by E.B.P.

Q. How do you reconcile, isn't there an apparent divergence between the documents, these two documents?

A. I don't know which of them was—let me see. Oh, the one—oh, I see here it is. This first document was prepared by the writer, Earl Heft, of this ruling and is dated 2/18/47.

The next document apparently was prepared by the digest people and is dated 2/27/47. I gather the first is the recommendation, earlier recommendation by Mr. Heft, and the second is the decision made by the publication and distribution people.

Q. Mr. Heft, as I understand, is one of the six specialists in this field; is that correct?

A. I think he was in 1947.

Q. Had he in fact been the one who apparently initiated Exhibits 2 and 3?

A. 2 and 3? Apparently so, his initials appear at the top, which ordinarily indicates that he initiated the rulings.

Q. You have testified that on the basis of your analysis here you discern only one difference between the ruling issued as Exhibit 4 and the ruling issued as Exhibit 2, isn't that correct?

A. I said that was one difference; I don't know that it was the only difference. This was a difference in the factual situation.

Q. Is there any other difference?

Mr. Duncan: Take your time, Mr. Swartz. Look through the exhibits.

The Witness: This is 2 and 4. (Examining documents) Of course, in Exhibit 4, our ruling permits the filing of two consolidated returns in order to get the parent and subsidiary on a basis so the consolidated returns can be filed.

By Mr. Davis:

Q. Whereas, Exhibit 2 only requires—actually, weren't there two consolidated returns filed?

A. Yes, yes; under 4, two consolidated.

Mr. Duncan: Exhibit 4.

The Witness: Exhibit 4.

By Mr. Davis:

Q. Not in 2?

A. Apparently in 2 there was one consolidated return period.

Q. You made reference to this confidential unpublished directive and then said that: "previously referred to". Was that "previously referred to" in the file or is that just your reference to our prior discussion of it here?

A. This is referred to in the file.

Mr. Duncan: Would you identify it.

Mr. Rothe: Would you read that into the record?

Mr. Duncan: He read it into the record before.

The Witness: Yes, in Exhibit No. 4, the document "Ruling Publication and Memorandum" under the question: "Should ruling be distributed?" the answer is "No", and under "If not, state reasons" it says, and I'll read it again: "See above reasons, except last; compare CUR 1661 . . ."

Mr. Duncan: Go ahead and read the rest of it, if you will.

The Witness: "The slight variation of facts from CUR 1661 not sufficient to require distribution. Principle is the same."

By Mr. Davis:

Q. All right, now, since Mr. Heft was the specialist at this time in the field, as I understand it; that is correct, isn't it?

A. He was one of them, as I understand it.

Q. And since he had initiated the ruling issued as Exhibit No. 2, how do you account for the fact that his opinion apparently was in disagreement with that of the publications or the Precedent people?

Mr. Duncan: Disagreement as to what? As to whether it should be distributed or it should be published or what?

Mr. Davis: I believe that there is a checkmark on the second document.

By Mr. Davis:

Q. What does that checkmark show?

A. On the document signed by Mr. Heft on February 18, 1947, apparently this relates to whether or not this should be included in the subject file. His reason for apparently saying it should be included in the subject file

is that it relates to a new issue and no ruling thereon in subject file.

Now, in the other document—

Mr. Duncan: Does the other document deal with the subject file?

The Witness: It says "Should ruling be digested", "Yes", which goes into the subject file. "Should ruling be submitted for publication?", "No"; "Should ruling be distributed?", "No", because the CUR was distributed. It was digested, it was digested.

By Mr. Davis:

Q. I see. Why do you think that Mr. Heft thought that this was a new issue?

Mr. Duncan: If you know.

The Witness: I don't know.

By Mr. Davis:

Q. Would you begin on the right side of the file?

A. I'd be glad to.

On the righthand side of the folder is a request for a ruling addressed to the Commissioner of Internal Revenue and dated September 25, 1946.

Mr. Duncan: Would you identify that as Defendant's Exhibit 4-A?

The Witness: It is Defendant's Exhibit 4-A.

The second document appearing in this folder is Defendant's Exhibit 4-B, and is a ruling letter to a taxpayer dated October 10, 1946, signed by the Deputy Commissioner of the Income Tax Unit.

The next document is Defendant's Exhibit 4-C and is a letter from taxpayer's representative to the Commissioner of Internal Revenue with respect to a reconsideration of their letter of September 25, 1946.

The next document is a memorandum dated October 30, 1946 and is a memorandum to the Chief Counsel from the Deputy Commissioner of the Income Tax Unit.

By Mr. Davis:

Q. What is the nature of this Communication?

A. This is a communication submitting to the Chief Counsel the proposed ruling letter, at that time being proposed, in which it was proposed to modify the ruling letter dated October 10, 1946, which is Defendant's Exhibit 4-B, with respect to the procedure to be followed by this taxpayer and its subsidiaries in making its returns for the current year, and is transmitted to the Chief Counsel for consideration and recommendation as to proposed action contained therein.

It is called to the attention of the Chief Counsel as the case is somewhat different from that upon which CUR 1661 was based, and the question that is raised is as to whether the parent company by reason of such acquisition and notwithstanding the fact that it will comply with provisions of the regulations as it was applied in CUR 1661 with respect to adopting an accounting period for 1946 to conform with the accounting period of the insurance company would be precluded from filing a consolidated return for the fiscal year ending September 30, 1946.

The next document is Defendant's Exhibit 4, which is the ruling to the taxpayer dated February 5, 1947, and does contain the initials of the Chief Counsel's office, the Technical Advisor to the Commissioner and is signed by the Commissioner.

The next document is a digest for the subject file of this ruling. I will read this substituting blanks for the name of the taxpayer:

Blank "and its subsidiaries file consolidated income and excess profits tax returns on the basis of a fiscal year end-

ing September 30th. The affiliated group acquired complete ownership of" blank "insurance company as of July 1, 1946. The insurance company files its returns on the calendar year basis, as required by Section 29.204-1 of Regulations 111. Held, for the purpose of filing consolidated returns, the parent corporation and its other subsidiaries will be required to adopt a calendar year accounting period in conformity with that of the insurance company. Held further, if the parent corporation and its subsidiaries change to a calendar year basis of accounting, effective December 31, 1946, consolidated income and excess profit tax returns may be filed for the fiscal year ending September 30, 1946, including the income of" blank "insurance company for the period July 1, 1946 to September 30, 1946 and a consolidated income tax return may be filed for the period October 1, 1946 to December 31, 1946 including the income of the insurance company for such period. Held further, the insurance company will be required to file a separate income tax return for the period January 1, 1946 to June 30, 1946."

It goes on to state that the ruling of October 10, 1946, which is Government's Exhibit 4-B, modifies it. That's all that's contained in this.

Q. And the ruling of October 10, 1946 has not been submitted to the Chief Counsel for review?

A. The ruling of October 10, 1946, no. Apparently it had not been, according to the file it was signed by the Deputy Commissioner of the Income Tax Unit and at least is not initialed by the Chief Counsel.

Q. Why was he asked to review the proposed modification issued as Exhibit 4?

A. I presume, in accordance with the transmittal to the Chief Counsel, I think, the reason the Deputy Commissioner submitted this to the Chief Counsel for an interpretation

is that under a strict interpretation of the regulations the denial of the right to file a consolidated return for the year requested would be justified but in view of the circumstances in this case and the apparent desire of the companies involved to fulfill the requirements of the regulations with respect to filing consolidated returns, it is believed the granting of such right would not jeopardize the government's interest and that from an administrative standpoint the proposed ruling is sound.

Apparently they were trying to see whether the Chief Counsel agreed legally with the administrative position proposed to be taken by the Commissioner.

Q. The file does not show the reply or the General Counsel's memorandum on this point?

A. There was apparently no General Counsel's memrandum submitted to the Deputy Commissioner, which quite often occurs; if they agree with the position, they merely initial the document, and this shows the initialing of the document by the Chief Counsel. Whether there were any internal memoranda within the Chief Counsel's Office, I don't know.

Q. How long is this memorandum of transmittal?

A. Of transmittal to the—

Q. To the Counsel.

A. From the Deputy Commissioner to the Chief Counsel?

Q. Yes.

A. Three paragraphs on one page, but it included the ruling letter which finally went out.

Q. Yes. I am wondering if you would, so that I can have that in focus, because this, I think, is a very significant document for us; would you mind reading those three paragraphs?

Mr. Duncan: Suppose we have a copy of it made, perhaps, and have it excised?

Mr. Rothe: That's all right.

Mr. Duncan: Let me look at it, here. (Examining document) Although I fail to see the relevance of this.

The problem here, Mr. Davis, is that this is an interoffice communication between the government and I believe Mr. Swartz has fairly summarized it. I don't think it is in the government's interest, as a precedent, to turn this over to you now.

We would think about it and have a copy made. He summarized the contents of it, but the actual turnover of the document itself, I think, we will resist at this time.

Mr. Rothe: How about reading the pertinent paragraphs?

Mr. Wilson: There are three in number.

Mr. Duncan: Three in number. He summarized them, in a fair and broad manner. He was quoting practically from some of them when he was reading them.

By Mr. Davis:

Q. It was because they seemed to be particularly relevant that we thought that they might be read in continuity here.

Mr. Duncan: I think he summarized them fairly, and that's the situation.

Mr. Rothe: Not that we doubt your judgment, Mr. Duncan.

Mr. Duncan: This is an interoffice, legal memorandum of the government with respect to what we will do. What we did do is in evidence, subject to your objection, and I think what we did do was the relevant consideration and not the reasons why we did it.

Mr. Davis: That's a profound statement.

By Mr. Davis:

Q. Is it apparent from the file at what time Dr. Heft's comment on the second document on the lefthand side of the file was made? Was it at the time of the original ruling?

Mr. Duncan: If that document is dated.

By Mr. Davis:

Q. What is the date of Mr. Heft's signature?

A. February 18, 1947.

Q. Thank you.

A. The date of the letter was February 5, 1947.

Q. How about the digest?

A. February 27, 1947. Well, February 27, 1947 on the M.M.S. initials and March 4, 1947 approved by E.B.P.

Q. The document marked Defendant's Exhibit 4-C refers to a conference held Monday, October 14, presumably October 14, 1946, between several representatives of the Bureau of Internal Revenue and representatives of the Tax Bureau. Is there anything in the files of the Internal Revenue Service which summarizes the people who participated at that conference, and what was discussed?

A. There is nothing in this file so far as I know about or relating to that conference, no, sir.

Q. Do you know of anything in any other file of the Internal Revenue Service?

A. I know nothing, no, sir.

Q. Referring now to Exhibits 2, 3, and 4, Mr. Swartz, is it not true that each one of them relates to the filing of a consolidated return with respect to the affiliation during the taxable year of an insurance company subsidiary with a parent on a fiscal year?

Mr. Duncan: You'd better read that question.

Mr. Davis: Strike the question and let me rephrase it.

By Mr. Davis:

Q. Do not the documents marked Exhibits 2, 3, and 4 deal with the filing of a consolidated return in a situation in which there has been a newly acquired subsidiary, an insurance company subsidiary on a calendar year by a parent on a fiscal year?

A. In each case the parent was on a fiscal year and so far as the insurance company was concerned, I'll have to check. (perusing documents)

Mr. Duncan: What was the other common denominator that you wished, Mr. Davis, for Mr. Swartz to cite in each case?

The Witness: In each case, the parent corporation is on a fiscal year basis and in each case the insurance company was on a calendar year basis.

By Mr. Davis:

Q. I see, but each of these cases deals with the acquisition, prospective acquisition of an insurance company subsidiary by a parent on the fiscal year; isn't that correct?

A. Yes, they have involved cases in which the parent acquired an insurance company.

Q. Is there any ruling, prior to December 31, 1950, to your knowledge issued by the Internal Revenue Service prior to that date which related to the filing of a consolidated return by a fiscal year parent and a calendar year insurance company subsidiary, other than Exhibit 1?

A. Before 1950?

Q. Yes, where they were already affiliated.

A. Apparently not.

Q. The same answer would apply if the date were extended to January 31, 1951?

A. Yes, I think the same answer would apply.

Q. In fact, the same answer would apply up until August 21, 1951?

Mr. Duncan: You're referring to Exhibit 5?

Mr. Davis: Yes.

The Witness: That was dated August 21, Exhibit 5 was dated August 21, 1951. The answer is yes.

By Mr. Davis:

Q. Thank you.

A. I would like to point out that in our Exhibit 5 in our ruling dated August 21, 1951, that on page 2 in the last paragraph on that page the Commissioner says: "it has been the policy of the Bureau in cases of this kind to permit the filing of the first consolidated return of an affiliated group upon the basis of the fiscal year of the common parent corporation".

Q. Do you know what the source of that statement is?

A. No.

Q. Is there any authority for it in any—

A. I was merely quoting from the Commissioner's letter in which he states that it has been the policy of the Bureau in cases of this kind to permit the filing of the first consolidated return.

Q. Suppose we go through this file then of Exhibit 5.

A. Beginning at the—

Q. Is there anything on the left side?

A. Nothing on the left side of the file. This is the entire file I have here.

The first document is a request for a ruling dated, the first item in the file is Defendant's Exhibit 5-B and is a request for a ruling addressed to the Commissioner of Internal Revenue from a taxpayer's representative, including the attachment which is also a part of Exhibit 5-B dated June 29, 1951.

The next item is a letter dated July 25, 1951, which is Defendant's Exhibit 5-A and addressed to the Commissioner of Internal Revenue and signed by the taxpayer's representative.

The next document is a copy of Defendant's Exhibit 5 dated August 21, 1951, which is a copy of a ruling to the taxpayer and signed by John B. Dunlap, Commissioner of Internal Revenue.

The next document is another carbon copy of that same ruling.

The next document is a carbon copy of that same ruling, but is the initialed copy.

Q. Why is it that we do not have the initials shown on the Defendant's Exhibit 5, whereas we do have the initials on the other?

Mr. Duncan: I'll state for the record why that is. I don't think Mr. Swartz would know. The reason is that written across the bottom is a reference to the name of the taxpayer which is so intermingled with the initials that I had to, in order to cut out the names I had to cut out a bunch of initials. However, I have no objection to Mr. Swartz referring to the initials, he can read them out for you for the record, and the name of the taxpayer is referred to with regard to a prior ruling. He might refer to that too.

Mr. Rothe: A what?

Mr. Duncan: A prior ruling, a CUR on another ruling. In other words, this is so intertwined with the ruling and the reference to the CUR on the prior ruling.

The Witness: At the bottom of the initialed copy of the ruling dated August 21, 1951 is a reference to CUR 1661, and also the name of the taxpayer of another—

Mr. Rothe: How does the reference read?

The Witness: It just says it, that's all.

Mr. Rothe: Does it say area involved or something like that?

The Witness: It just says, down here in ink, above the initials, together with the initials is CUR 1661—5/26/45.

Mr. Duncan: There is also another reference.

The Witness: There is another reference which is the name of the taxpayer, the name of the taxpayer being the taxpayer involved in Defendant's Exhibit 4.

Mr. Duncan: And there is the date.

The Witness: And the date, February 5, 1947.

By Mr. Davis:

Q. What would have been the occasion for making these references do you think?

A. It could have been with respect to whether or not this should be distributed or made into another CUR.

Mr. Duncan: Could you read some of the initials for Mr. Davis, who initialed them across the bottom?

The Witness: Yes, the initials are ECH, which apparently is Earl Heft; CPS, who I believe—

By Mr. Davis:

Q. Could you give the dates?

A. 8/14/51. CPS, 8/14/51, with the initial below that F, which apparently is Dan Ferris initialing for Charles Susman, who was then, I believe, Chief of the Branch. There is CNT, who is, I believe, Clarence Thurston, who was Technical Advisor to the Deputy Commissioner. There is FTE—

Mr. Rothe: Is there a date there?

The Witness: 8/17/51. There is FTE, who is Frank Eddingfield, who was a senior Technical Advisor to the Deputy Commissioner, and there is a further initial—

Mr. Rothe: Date?

The Witness: 8/20/51. There is the initial EIM with the initial E below it which indicates that Mr. Eddingfield

initialed for Mr. McLarney, the Deputy Commissioner, on 8/20/51. There is the initial LS which apparently is Leo Spear, who was the Technical Advisor to the Commissioner, 8/20/51. There is another initial JC without any date. I think that—I don't recall the man's name but I think this was another man in—I'm just not sure what initial that is, but it appears to be JC. After that FM, 8/21/51, and that apparently is Fred Martin, who was the Assistant Commissioner, I don't know whether he was designated Technical at that time or not, but they had two assistant commissioners and Mr. Martin was an Assistant Commissioner.

Also in the file—

By Mr. Davis:

Q. Is there anything to show the referral of this review by the Chief Counsel?

A. Nothing in here that indicates that this was sent to the Chief Counsel, no.

There is a document attached to this file which is called "Subject File Recommendation". Again, this apparently is a—whether or not this should be recommended for inclusion in the subject file, with respect to whether it should be included in that it interprets, distinguishes, modifies, revokes or affirms. None of those boxes are checked.

It says: "Or a distributed ruling", written in ink, apparently by Earl Heft, is CUR No. 1661, dated 5/26/45, and it goes on to say or another ruling in the subject file, and it refers there also to the taxpayer's name which is the taxpayer to which Defendant's Exhibit 4 was issued, dated February 5, 1947, and it is signed by Earl C. Heft on 8/14/51 and is approved by the reviewer, DF, who apparently was Dan Ferris, on 8/14/51.

That is all that is in this file.

Mr. Rothe: I am not sure I get the significance of the inked in material by Earl Heft. What does it refer to?

The Witness: The subject file recommendation is printed out and all that the reviewer needs to do is check a box or write in his recommendations. With respect to the different material which says, it is recommended for inclusion in the subject file for the reasons that it is a distributed ruling and he says—he writes in after that, see CUR No. 1661 dated 5/26/45, and under the printed heading another ruling in subject file, it refers to the taxpayer's name to which the February 5, 1947 letter was addressed.

Mr. Rothe: Is he saying there—is he checking a box of any kind?

The Witness: He has not checked a box.

By Mr. Davis:

Q. What question is he answering?

Mr. Rothe: What question is he answering by this material?

The Witness: Apparently since he hasn't checked the box which says it is recommended for inclusion in the subject file, because it interprets, distinguishes, modifies, revokes or affirms, since he hasn't checked that, then apparently this is just a notation with respect to the material that is in there, in the file.

Mr. Rothe: Consequently there was no recommendation that this be placed in the Precedent File, and it was not so placed?

The Witness: This is not from the Precedent File.

By Mr. Davis:

Q. Now, as I recall, Mr. Swartz, this is a ruling letter which was found after your affidavit was executed; is that right?

A. Of that I'm not sure.

Mr. Rothe: It has been so stipulated.

Mr. Duncan: It was stipulated that it was.

By Mr. Davis:

Q. Do you see any support in the prior rulings letters that in your opinion—what is the support, if any, in prior ruling letters—

Mr. Duncan: I think I'll object to that; the rulings speak for themselves.

By Mr. Davis:

Q. Do you have any explanation for the source of the statement in the last paragraph of page 2 of Exhibit 5 to which you referred?

A. I assume that the writer of this document, particularly since he referred to the CUR in the other case, that it was his—

Mr. Duncan: By "the other case", do you mean the ruling—

The Witness: I mean the ruling dated February 5, 1947, which is Exhibit 4 and which was referred to by Mr. Heft in the document in this file.

(Continuing) That he must have assumed that a practice or policy or position had been established which applied to this particular situation.

By Mr. Davis:

Q. This is an assumption?

A. I did not ask Mr. Heft at the time, no.

Q. I believe this is our first file—

Mr. Duncan: Could we have a break here, Mr. Swartz has been testifying steadily for two and a half hours and I think it might be appreciated if we could have a short break.

(Recess.)

By Mr. Davis:

Q. I believe you mentioned that this was a file which was not in the Precedent File, Exhibit No. 5?

A. Exhibit 5.

Q. Would you describe how that file is indexed and marked so that it could be located?

A. It is marked not only under the name of the taxpayer, but it also has typed up in the upper righthand corner of the document "Consolidated Return".

Q. Are there any numbers?

A. No.

Q. Or other identification?

A. No, no numbers.

Q. Is there a tab on the file?

A. There's a tab on the file, but I don't think that this is the tab that was on the file when it was pulled out of the file.

Q. This is not the file?

A. This is the file (indicating). I don't know whether it was in a folder or whether it wasn't. This is a new folder, apparently that it was placed in.

Mr. Rothe: May the record show that the witness when referring to the file was referring to a sheaf of 8 by 11 papers stapled together.

Mr. Duncan: With a loose tab on the front which he referred to.

Mr. Rothe: With a loose half sheet or half cardboard.

Mr. Duncan: Yes, with the subject.

By Mr. Davis:

Q. Referring to Exhibit 6, would you take us through that file, please?

Mr. Duncan: I understand by this, you are waiving your objections as to relevancy here.

Mr. Rothe: Not one bit.

The Witness: Starting with the bottom part of this file, there are an original and three copies—or original and two copies of the contingent fee statement signed by the taxpayer representative.

By Mr. Davis:

Q. What date?

A. There is no date. It's recorded on May 8, 1953, in the Power of Attorney Section.

There is an original and two copies of power of attorney from the taxpayer to a representative which was recorded on May 6, or, maybe—I can't tell, it's blurred. It's either May 6 or May 8, 1953. I don't particularly know why this is, but there is another original and two copies of contingent fee statement, and then another original and two copies of the power of attorney, the same dates.

Then there are two copies of a request for ruling dated, which are the same as Defendant's Exhibit 6-A, which is a request for a ruling addressed to the Commissioner of Internal Revenue, signed by the taxpayer's representative.

There is a copy of a letter dated May 7, 1953 to the taxpayer's representative signed by the head of the Technical Rulings Division, referring to the request for ruling dated May 4, 1953 in which it states that a request for conference has been arranged for two p.m. May 11, 1953. There are eight copies of that.

There is a letter, ruling letter dated May 22, 1953 to the taxpayer's representative which is the same as Defendant's Exhibit 6, signed by the head of the Technical Rulings Division, besides the Commissioner and by the head of the Rulings Division. There are then three more copies of that ruling and attached—

Mr. Duncan: That's not really part of the file.

The Witness: No, it isn't part of the file.

Mr. Duncan: That's not part of the ruling file. I have no objection to your referring to it, but it isn't covered by the question.

The Witness: That constitutes the file.

By Mr. Davis:

Q. Do you know where this file was located?

A. I presume this file was located in Miss Benesh's file, is that right? The indication on here indicates that this was a folder that was taken from the file of Miss Benesh.

Q. Who is Miss Benesh, for the record?

A. Miss Benesh is in the—oh, she apparently had it for some reason. Miss Benesh is in the Tax Rulings Division and this was gotten for her but is or was apparently in our general files under the title of "Consolidated Returns".

Q. Although the ruling is signed in your name and do I understand that it was signed for you by someone else; is that right?

A. Ordinarily—I am not so sure what in effect in '53. Under our present procedure, had I signed it, I would have initialed it. Under some procedures the signer did not initial. I can't really say whether I signed this or whether I didn't. It's quite possible that Mr. Thurston, Mr. Thurston who is Technical Advisor to the Technical Rulings Division, at that time had authority to sign my name. I can't really say whether I signed this or whether Mr. Thurston signed it.

Q. This apparently was never considered for digesting or for publication; is that correct?

A. Apparently not, there is nothing in the file to indicate that this was.

Q. Why would that be, that certainly rulings are apparently considered by publication?

A. Well, let's see. In '53, I think it was not until 1954 that we had a system of referring matters for publication. In other words, in '54, we entered into our publication—I may be wrong. I'm trying to think of the year in which

we started our publication policy. Anyway, there is nothing to indicate here that this was or was not considered. In any event, there is nothing in the file to indicate that it was referred for publication or referred to the digest file.

It was placed in the general files under the heading "Consolidated Returns".

Mr. Rothe: In case it might refresh your recollection, Mr. Swartz, I believe your change of publication policy was announced in Revenue Ruling 2, which was in the 1953, one, accumulative bulletin, page 484. Does that refresh your collection as to when?

The Witness: Do you know what weekly bulletin it was in?

Mr. Rothe: That I don't have.

By Mr. Davis:

Q. It must have been early because, bearing the number 2—

A. It was early, when we decided, that was the first ruling to announce our publication, but it wasn't necessarily in January. It was one of the first announcements. It could have been later on.

Mr. Rothe: It had to be within the first six months because it was dash one.

The Witness: It would have to be within the first six months.

Mr. Rothe: And it is page 484 of that.

By Mr. Davis:

Q. The paging has no relevance.

Mr. Rothe: That's true; it's rearranged afterwards.

Mr. Duncan: Is there a question pending?

By Mr. Davis:

Q. Referring to Exhibit 7, would you identify the papers in that file? What appears in the pages on the left side?

A. On the left side is—the first document appearing on the left side of the file is a document printed, a printed document which has certain questions which is entitled "Ruling Publication Memorandum". This form is to be completed for each communication considered for purposes of publication by the Bulletin Branch.

It gives the taxpayer's name, the address, the date of the Ruling, January 18, 1956.

Mr. Duncan: Give them the questions and answers.

The Witnesss: Question number two: "Is ruling covered by law, regulations, public rulings or decision?" The answer is "No", the answer being put in by the ruling analyst.

"Does ruling modify or revoke a principle of any published ruling?" and the answer is "No".

"Does ruling affirm, modify or revoke a principle of a CUR or AM?" "No."

"Should ruling be published as a Revenue Ruling?" "Yes". "If answer to 5 is no, should ruling be digested?" And the answer is "No", with the initials J.S.D.

The next document is index classifications of rulings for the Research Facilities Section. This, again, is a mimeographed or printed document which requires certain information to be added, the section of law involved or regulation, put in in pencil "Section 1502, Internal Revenue Code of 1954". And for index classification "Section 1502, Regulations Consolidated Returns, Section 831, Tax on Insurance Companies, and Section 204, Tax on Insurance Companies and Consolidated Returns and Change in Accounting Period, with the initials J.S.D.

Q. What is the purpose of this document, this last one?

A. Apparently this is the document to index this ruling in order for it to be placed in the Research Facilities files.

Now the Research Facilities File Section was a new, somewhat new section as a result of the reorganization of the Service. The filing of rulings was centralized in one place in Technical, since under the reorganization the Tax Rulings Division undertook also to rule in areas other than income tax. The files of other taxes were combined in the Research Facilities Section.

Q. This was taking over the so-called Precedent Files?

A. Precedent Files and the files of other Deputy Commissioners, apparently including estate, gift, excise and so forth, combining them under one file, and the purpose of this is to classify this particular file under an index.

The next document is apparently a proposed—well, let's see. It's a mimeographed memorandum which is used by the Bulletin Branch, the Bulletin Branch being a new branch under the reorganization, also, which undertakes to prepare and publish rulings in the Internal Revenue Bulletin.

This is a mimeographed memorandum to the Chief Counsel which they used to transmit proposed revenue rulings to the Chief Counsel for their review, signed by the Chief of the Bulletin Branch.

There is a mark across it so I can't tell at this time whether or not it was decided not to send it, or what. Maybe the file will show that further on.

The next one is another document prepared in the Bulletin Branch merely to record and highlight or to record rulings recommended for publication. Section of the law involved, a proposed highlight entry, if it is published, the highlight to appear on the covers of the Internal Revenue Bulletin, and the entries in the index file that are to be made. There again it's indexed under "Income Tax Accounting Period, Affiliated Group, Including an Insurance Company, Consolidated Returns" and also under

"Returns" under "Consolidated and Affiliated Group, Including Insurance Companies" and under "Accounting Period".

Q. What use was made of that and to whom was it addressed?

A. This is just a form for the use of the Bulletin Section or the Bulletin Branch in connection with the preparation of review and approval of editorials to appear with material to be published in the Internal Revenue Bulletin.

Q. Is there any indication to whom it went? Did it go outside the Bulletin Branch?

A. No, I think it just follows the file for purposes of —when they get ready to publish the ruling, that this— and when they get ready to file the material that is filed under these index entries and that the highlight entry would probably be used for the highlights occurring on the front page of the Bulletin.

The next document is again a printed form which is headed "Ruling Publication Memorandum" and this gives a considerable amount of material with respect to the research that needs to be done. In other words, this was a document that was used by the Bulletin Branch in taking a Revenue ruling, researching it to see whether or not it modified any other published rulings, revoked any other published rulings, the section of law involved.

Q. Could you read what it says there?

A. Yes, I was explaining.

Q. Excuse me.

A. Then it also goes on to cover the action to be taken. There is a block as to whether to publish or whether not to publish, and these are all in boxes in this form, so that it gives the name of the taxpayer, the date, symbols, the ruling, section of law involved.

It says: "8/31, 1502, Section of the Regulations involved 1.1502-14". Apparently in researching this, they also look

at tax services to see whether or not there is any mention made in tax services of this item. The material here is recorded as 594 CCH paragraph 4903 and 593 CCH paragraph 4053. I really don't know what that means.

Then it has regulations paragraph 1.1502-14-C. The next question is: "Pertinent court decisions", "None". "Section, tickler file". "Cite related cases", "none". "Research Facilities Section, cite precedent cases, other than published rulings, or those quoted in the tax services", "none".

"Other relevant authorities found", "none".

"Is ruling covered by law, regulations, published rulings or decision?" It is recorded here as Regulations paragraph 1.1502-14-C.

Question: "Does ruling modify, or revoke a principle of any published ruling?" "None".

Next question: "Does ruling affirm, modify or revoke a principle of a CUR or AM?" "None".

"Action to be taken", the block for publish is not checked, the block for do not publish is checked.

Also it is checked for "do not digest" or "digest".

Mr. Duncan: It's checked for digest.

The Witness: It's checked for digest.

There is a little document here as to whether this has— I might say—well, this isn't really in order of chronology. Should I refer to the date of this document?

Mr. Duncan: Yes, if you want to.

The Witness: This document, this last document that I am referring to was initiated on November 12, 1959. There is another document here as to whether—

By Mr. Davis:

Q. What is that document?

Mr. Duncan: It's the one he has been referring to.

Mr. Davis: Oh, I see.

The Witness: There is another little sheet, piece of paper; it's a document which apparently is a notification as to whether in publishing this ruling it has a top priority or secondary priority. This is marked as a secondary priority.

There is a memorandum routing slip in which there is a memorandum through the Bulletin Branch apparently in which it says the case has not been recommended, or has been recommended for nonpublication; however, it is being sent for digest purposes. I don't know whether that's a part of the file, but there are two little scribbled notes which apparently are not part of the file.

Mr. Duncan: No, they are not part of the file.

The Witness: On the righthand side of the file is the original and apparently two copies of a request for ruling dated December 28, 1955, which is the same as Government's Exhibit 7-A.

Mr. Duncan: May I clarify something here, Mr. Davis. Government's Exhibit A on page 2 refers to Exhibit A and Exhibit B to that request for ruling. What are those?

The Witness: Exhibit A is a quote of the applicable code and regulations sections, it refers to Code Section 831-A, to Code Section 204-A-1 and then it goes on.

Mr. Duncan: A number of sections?

The Witness: A number of regulations sections.

Mr. Duncan: What is Exhibit B to that?

The Witness: Exhibit B, the taxpayer has attached to this request for a ruling a copy of our ruling letter dated February 5, 1947, which is the same as Defendant's Exhibit 4.

The next document is—

By Mr. Davis:

Q. Did you say that on the righthand side there were some papers that were not really part of the file?

A. On the lefthand side. There were two penciled things here that I don't think are part of the time, just some scratching of some kind.

Q. Oh.

Mr. Duncan: Why don't you go on, Mr. Swartz.

The Witness: The next document is a copy of a ruling letter to a taxpayer, dated January 18, 1956, which is the same as Defendant's Exhibit 7, signed by the Director of the Tax Rulings Division, and in this particular case it is apparent that my name was signed by Mr. Thurston.

The next document is merely a transmittal memorandum sending this along the line to Mr. Cleos, who was Assistant Chief of the Branch at that time.

The next document is to the same taxpayer dated January 18, 1956 which is in answer to application filed by the taxpayer on form 1128 requesting permission to change its accounting period. This letter grants permission to change the basis of filing of this taxpayer's federal income tax return from the present taxable year to a new taxable year. The present taxable year in this case ending on September 30. I'll read this:

"Your present taxable year ends on September 30th. The last prepared on the present basis is for the year ended September 30, 1955. Your next taxable year ends on December 31. In order to effect the change to the new basis, your return will be required for the short period beginning October 1, 1955 and ending December 31, 1955."

Shall I go on? It's the usual form.

By Mr. Davis:

Q. Is this a form 1128?

A. This is a ruling letter which is in answer to a form 1128.

Q. Is the form 1128 in the file?

A. No.

Q. Where would that be?

A. Wait a minute. I don't see the form 1128 in the file, in this file.

Mr. Duncan: It's not in the file?

The Witness: It's not in the file.

By Mr. Davis:

Q. Wherever reference has been made in these letter rulings marked Exhibits 2 to 7 inclusive to a condition that the parent company adopt a fiscal, or rather, a calendar year as a condition, wherever that has been specified, has there been any check made to see upon what conditions the consent was granted?

A. Yes.

Q. Do you have the files that would show?

A. We have some files indicating the request for a change and the granting of the request for the change.

Q. And the grounds for the request as well?

A. I'd have to check the file. These—many times these answers granting requests to change accounting periods are in form letters which are merely typed in with the dates which the returns are to be filed for and granting the request and containing a paragraph indicating that the—for example in this one, the net income shown on the short period return required to effect the change must be paid on an annual basis and computed in accordance with Section 443-B.

The next document is another bulletin publication recommendation in which the question is asked, or a publication recommendation and it has two boxes marked "publish" and "Do not publish", and this is checked publish.

Q. By whom was this prepared?

A. This apparently was prepared by a man to whom it was referred in this case, originally by D.D. who is David Deutsch. Dated January '56.

In the form of the publication it is checked recommended for publication in full text form.

Q. What is the next document after that? Is there anything to show the disposition made?

A. Not at this point. This is merely a recommendation, here.

The next document is a draft of a Revenue ruling. This apparently was prepared in the Bulletin Branch as a result of the recommendation made in this last form I referred to to publish the document.

On top of that is a memorandum from the Chief of the Bulletin Branch to the Director of the Tax Rulings Division transmitting a copy of the proposed Revenue ruling asking for consideration and review of the proposed Revenue ruling.

That has at the bottom of it a return memorandum to the Bulletin Branch for the signature of the Director of the Tax Rulings Division with three boxes: one "has my concurrence"; two "has my concurrence with the changes shown"; three "it does not have my concurrence for the reasons stated in the attached memorandum". The box that is checked is "has my concurrence with the changes shown". This is signed in my name by Mr. Thurston, Technical Advisor to the then Director of the Tax Rulings Division.

The next document is a copy of the proposed Revenue ruling, with apparently some minor pen and ink changes.

The next document is dated June 11, 1956, it is a transmittal memorandum to the Chief Counsel signed by the Chief of the Bulletin Branch. It is merely a form letter which is used for transmitting a proposed Revenue ruling for publication to the Chief Counsel for their consideration.

The next document is a memorandum from the Chief Counsel to the Bulletin Branch through the Assistant Commissioner Technical—

Q. What does that refer to, generally?

A. It refers to the proposed Revenue ruling which was referred to them for their consideration.

Q. What disposition was made of the recommendation for publication?

A. They recommend—

Mr. Rothe: Who is "they"?

The Witness: The Chief Counsel. The memorandum signed by, at least in the name of the Chief Counsel, recommends nonpublication of the ruling.

By Mr. Davis:

Q. Any grounds?

Mr. Duncan: Give them the grounds as stated here.

The Witness: Chief Counsel says they believe proper solution to the problem presented should be effected in amendment to the consolidated regulations.

The next document is a memorandum from the Chief of the Bulletin Branch to the Director of the Tax Rulings Division and the attention of the Chief of the Corporation Branch.

This memorandum is dated February 18, 1957 and merely informs the Chief of the Corporation Branch that the Chief Counsel feels the solution to this problem should be an amendment to the regulations and they should undertake—the L & R division of that office, with concurrence of the Technical Planning Division should undertake a project to effect such an amendment.

Mr. Duncan: What is the date of that?

The Witness: This is dated February 18, 1957.

The next document is merely a cover document which is a memorandum to the Bulletin Branch which says: "Do not publish", in view of this memorandum.

By Mr. Davis:

Q. Is there anything in the memorandum—

Mr. Duncan: There is now just one more document. Let him finish.

The Witness: There is just one more document which is the reply of the Chief of the Corporation Branch to the Chief of the Bulletin Branch. This is dated March 5, 1957, and it is indicated that this office agrees with the Chief Counsel's opinion with respect to the matter.

By Mr. Davis:

Q. This is from what office?

A. This is the reply back from the Chief of the Corporation Tax Branch to the Chief of the Bulletin Branch referring to his memorandum of February 18th in which he advises the Chief of the Corporation Branch of the opinion of the Chief Counsel.

Q. Is there anything in the opinion or the communication from the Chief Counsel which indicates why regulation is thought to be required as a solution to the problem?

A. It says the L & R Division of this office has in concurrence with the Division of Technical Planning undertaken the project to amend the consolidated return regulation to provide a solution to the problem raised by the instant case.

Q. Does the memo refer to a so-called General Counsel's Memorandum, GCM?

A. This is a GCM.

Q. GCM.

A. This is a GCM and it doesn't refer to any other GCM.

Q. Was there outstanding—there was a reference on one of the documents on the lefthand side of the file relating to Regs. 1-1502.14-C.

A. Yes.

Q. Is this the regulation which carried out the recommendation of the Chief Counsel in this memorandum?

A. I would guess on it at this point that that might be so. The GCM is dated in 1957 and the document referring to regulations 1.1502-14-C, which refers to published rulings and probably also means regulations was dated November 12, 1959.

Q. The Chief of the Corporation Tax Branch indicated that he concurred in the recommendation of the Chief Counsel; is that correct?

A. The procedure there was that if a ruling were submitted for publication, recommending publication, then eventually somewhere along the line someone objected to that recommendation after the Bulletin Branch had proceeded to prepare a Revenue ruling, that the Bulletin Branch had no authority to stop it; they had to send it back to the office of origination to get permission or to let them know and at least get their reaction to the recommendation not to publish.

Q. What would happen in the event of a disagreement between the office of origin and some other office?

A. Oh, I think that probably they would at this point, if there was a disagreement with respect to any parties in connection with the review as to publication, the chances are the parties would get together and attempt to reconcile their positions. If they couldn't at that level, they would probably refer it to the Director of the Tax Rulings Division, the Head of Interpretative, whoever it was that needed to get together and finally resolve it.

Mr. Duncan: You had better identify what interpretative is.

The Witness: Interpretative Division is the Division of the Chief Counsel's Office to which proposed Revenue rulings were referred for their comment or consideration.

By Mr. Davis:

Q. Is there any reason given as to why it is thought that the issuance of a ruling would not be an appropriate procedure, why a regulation was preferable?

A. The memorandum from the Chief of the Corporation Branch to the Chief of the Bulletin Branch indicates that the Chief Counsel had advised that steps were being taken in the Technical Planning Division to amend Section 1.1502-14(a) of the regulations to provide a solution to the problem presented in this case. The administration file is retained in the suspense file apparently for the purposes of seeing whether or not this Revenue ruling needs to be published after the regulations are promulgated.

Q. How about the Chief Counsel's memorandum?

Mr. Duncan: He read you the part from that, I believe.

By Mr. Davis:

Q. It didn't indicate why, why the regulation was necessary and why publication was inappropriate.

Mr. Duncan: I don't think he testified that a regulation was necessary.

Mr. Davis: I thought he did.

The Witness: The Chief Counsel says that the proper solution to the problem presented requires an amendment to the consolidated return regulation. The purpose wasn't—

By Mr. Davis:

Q. Why?

A. I mean this is the Chief Counsel.

Q. He doesn't elaborate as to why proper solution requires this, requires regulation rather than a ruling?

Mr. Duncan: He does and he doesn't. Mr. Swartz testified for what it does and it does not elaborate in that memorandum.

Tell Mr. Davis whether there is an elaboration on that point.

The Witness: The only elaboration is that it refers to the conflict between Section 843 of the code and Section 1.10502-14(a) of the consolidated returns regulations, which conflict is the reason why this practice has grown up in the Commissioner's office, to take care of that conflict in the regulations, as I understand it.

By Mr. Davis:

Q. Does he refer to the practice, to this as the practice?

Mr. Rothe: What you have just said, is that your own understanding or is that from the GCM?

Mr. Duncan: Now, just wait a minute. Let him answer one question at a time.

Mr. Davis' question is pending.

The Witness: This merely refers to his recommendation that there is a conflict between these two sections and he refers to section 843 of the code and section 1.1502-14(a) of the consolidated return regulations, and he says, in the opinion of this office—"It is the opinion of this office that the proper solution to the problem presented requires an amendment to the consolidated return regulation."

Mr. Duncan: Go on then.

The Witness: "and the L and R division of this office has with the concurrence of the Technical Planning Division"—and the Technical Planning Division is the Division of the Commissioner's Office or in the Technical Office that also deals with regulations. I go on to quote "undertaken a project to amend the consolidated return regulations to provide a solution to the problem presented by the instant case. In view of this the proposed Revenue ruling is returned without the approval of this office".

By Mr. Davis:

Q. Did you interpret, was this accepted as an expression by the Office of the Chief Counsel that the ruling was not in accord with existing directives, published directives?

A. I gather that what they said was rather than publish this position as a Revenue ruling that the problem should be solved by using the regulation processes, rather than the publication of a ruling. To that extent the ruling was held in abeyance.

Q. But as I understand you, the opinion says that there is a conflict between the consolidated return regulations and the regulations relating to the filing by insurance companies on a calendar year?

A. Oh, yes.

Mr. Rothe: My question was—I am going to have to ask you to drop back and pick up Mr. Swartz' characterization of the contents this GCM.

(The answer of the witness and Mr. Rothe's question were read as follows by the reporter:)

The Witness: The only elaboration is that it refers to the conflict between Section 843 of the code and Section 1.10502-14(a) of the consolidated returns regulations, which conflict is the reason why this practice has grown up in the Commissioner's office, to take care of that conflict in the regulations, as I understand it.

Mr. Rothe: What you have just said, is that your own understand or is that from the GCM?

The Witness: Well, if I understand the question correctly, what I said was that it was the conflict in these two regulations that caused the taxpayers to ask us what could be done about filing consolidated returns in view of the conflict in those regulations, and it was with the knowledge of the conflict in the regulations that—and I will say practice, policy, position, procedure was adopted whereby the Commissioner would find the means of granting these affiliated groups a way to file consolidated returns, despite the conflict. And the way that he found a way to do that is reflected in the rulings which were issued in this area.

Mr. Rothe: Mr. Swartz, my question was whether this is your understanding or is this what the GCM says?

The Witness: Oh, this is my understanding.

Mr. Rothe: That's all I asked. Thank you, sir.

By Mr. Davis:

Q. Mr. Swartz, you have testified that you are in charge not only of the issuance of rulings and regulations and requests for technical advice and you also respond to requests for changes in accounting methods and accounting periods, to your knowledge has there been issued by your office since the date of Exhibit 7, here, any ruling or request—or any ruling or letter of technical advice relating to the filing of a consolidated return by a parent on a fiscal year and a subsidiary insurance company on a calendar year?

A. I have no personal knowledge of any such ruling or any such request.

Mr. Duncan: I'm sorry. Is your question whether there have been any rulings subsequent to this?

Mr. Davis: Yes.

Mr. Duncan: All right. Okay, and I think he answered that.

By Mr. Davis:

Q. Have there been any rulings in which the issue of whether a subsidiary on the calendar year has the privilege of filing a consolidated return with the parent on the fiscal year, or any letter of technical advice in which this issue was involved?

A. You mean, this where an insurance company is involved?

Q. Yes.

A. With an insurance company involved, I know of no rulings that have been issued other than those we have discussed here today.

Q. I see.

Are you not familiar with a letter of technical advice issued to the District Director of Internal Revenue at Chicago in respect of the plaintiff in this particular case?

A. I think I addressed myself to rulings at this point.

Q. I see. I intended—I thought my question covered both rulings and letters of technical advice.

Mr. Rothe: Would you repeat the question.

(The question was read by the reporter as follows:)

By Mr. Davis:

Q. Have there been any rulings in which the issue of whether a subsidiary on the calendar year has the privilege of filing a consolidated return with the parent on the fiscal year, or any letter of technical advice in which this issue was involved?

A. I interpreted your question as being a request for a ruling with respect to whether a taxpayer who was requesting permission to change to a consolidated return. I am familiar with the consideration of the request for technical advice that was submitted in connection with this particular case.

Q. Do you have the file in the matter here?

Mr. Duncan: Yes, we have the file.

By Mr. Davis:

Q. Would you take us through the file in the same manner that you have in the other files?

Mr. Duncan: Could you tell us why this is relevant here.

Mr. Wilson: Just give us some idea.

Mr. Davis: There is asserted to have been a practice or some operation here that resolves the conflict between the regulations, an admitted conflict between the regulations and we would like to know how this has been considered and disposed of.

Mr. Wilson: You mean a request for rulings?

Mr. Davis: Sir?

Mr. Wilson: You mean a request for rulings, or what?

Mr. Davis: This I understand was a request for technical advice, at least the taxpayer was so advised. It is just within the same area as all these others.

Mr. Duncan: The sole one in here is a letter addressed to the taxpayer. The sole intergovernment request is the '44 one that resulted in a letter to the taxpayer, and it is not to my knowledge that your case resulted in any letter to the taxpayer, except for statutory notice of deficiency.

Mr. Davis: We have had offered in evidence several files, extracted from the records of the Office of Assistant Commissioner, Technical, bearing upon the area of the eligibility and the procedure whereby a parent on a fiscal year might be permitted to file a consolidated return with the insurance company on the calendar year.

The question here is a further effort to find out just how this question has been considered in another instance, the only instance of which this taxpayer has personal knowledge, and the determination of this issue, how this general area was handled is thought to be relevant, proper, and there may be admissions against interest by the defendant and we certainly know of no—

Mr. Wilson: That is between its own officers you want admission against us?

Mr. Rothe: Absolutely.

Mr. Wilson: All we have produced is the ruling file, seven ruling files that have gone to people in the way described by the witness and with the effect described by the witness.

Mr. Davis: If you know some ground upon which this is not—these documents are subject to privilege, I suppose you are in a position to claim it, but we certainly intend to ask the question and to seek an answer.

Mr. Wilson: I think you have skipped a point. You said, and rightly, that the documents are subject to privilege; before we get to the question, some relevance must be shown. So far you haven't shown any. Now, whether we will invoke privilege ultimately or not is another question, but we do invoke relevance, at this point.

Mr. Davis: To the extent that the memorandum from the Chief Counsel relating to Exhibit 7 acknowledges the existence of a conflict between the service regulations or the treasury regulations, rather—

Mr. Duncan: I think if you will look at the exhibits, in every one of those Revenue rulings, practically, there is set out the fact that there was a conflict.

Mr. Davis: All right. The question, then, whether there was a privilege to a taxpayer on the calendar year, an insurance company taxpayer to file a consolidated return with a fiscal year parent and the factors which enter into this determination on the part of the Internal Revenue Service are surely as relevant in the case of this taxpayer as in the case of all these seven others which have been considered here.

Mr. Rothe: Really more.

Mr. Wilson: With this taxpayer it wasn't a question of a ruling.

Mr. Davis: The taxpayer did request the technical advice.

Mr. Wilson: It wasn't a request for a ruling. This is what we have been discussing all afternoon.

Mr. Davis: Actually, the issuance of a letter of technical advice has priority, if you please. It is certainly considered on the same level as the letter ruling to a taxpayer.

Mr. Rothe: Perhaps Mr. Swartz could establish that for the record.

By Mr. Davis:

Q. Is there a directive, Mr. Swartz, relating to the issuance of letters of technical advice?

A. There are procedures in connection with technical advisory memorandums, yes.

Q. Are letters of technical advice considered in any different way, is there any difference in responsibility for the preparation and issuance of letters of technical advice and for issuance of ruling letters to taxpayers?

A. Oh, yes.

Q. What are they?

A. Ruling letters, of course, are sent to taxpayers. Requests for technical advice are submitted by our field offices and our advice goes to the field office without any communication to the taxpayer; in fact, not even any communication to the taxpayer as to what the result of our technical advice is.

Q. This deals with the communication to whom communicated. Within your own office, what differences are there in the procedures for consideration of the request for technical advice and for ruling letters?

A. The problems that are submitted by the Revenue Agents are probably similar and no different than the problems submitted by taxpayers, with the exception that problems submitted by Revenue Agents are usually in connection with issues that they have under audit and they are not in connection with what they can do or what are proposed transactions.

Q. What is the significance of this difference? Does it alter the principles involved, the substantive principles involved?

A. I'm not sure I understand your question. Insofar as a ruling is concerned, a taxpayer need not follow. It's short of a closing agreement. In connection with the request for technical advice, the memorandum is merely our

opinion with respect to the question proposed, and there is a procedure whereby, if the field office does not agree with our proposal, they have the authority to write back and ask us to reconsider our position.

They merely adopt the position we have taken. They are not necessarily bound by it. They adopt the position taken in our consideration of the question and our advice; they adopt it as their position.

Q. Is there, then, any basic difference in the review processes within your own office of a proposed letter of technical advice from a letter of ruling, the ruling letter to a taxpayer upon the same general subject matter?

A. There is no difference in the review procedure, no.

Q. If a request for technical advice involved the question of the circumstances under which a fiscal year parent could file a consolidated return with a calendar year insurance company subsidiary and involved the same circumstances as were set forth in a request for letter ruling, would there be any basic difference in the response or in the consideration and the type of response which would issue from your office?

A. I think it would depend on the question. We would respond to the particular question that was raised by the Revenue Agent. If the question, let's say, received, the request for technical advice was on an issue which was in a return already filed, was identical with a taxpayer's request which had not yet consummated his transaction but wished to consummate his transaction, the procedure would be the same.

In some situations, however, a wary taxpayer has to, for example, if the Revenue Agent had a transaction whereby they had transferred securities outside the country without getting permission from the Commissioner under Section 367, the procedure, of course, I think would be different.

Q. Right.

Now, is it not true, Mr. Swartz, that a letter of technical advice addressed to the District Director of Chicago with respect to the taxpayer, in this case the plaintiff, Allstate Insurance Company, did bear upon the entitlement, the asserted entitlement of the parent, the fiscal year parent and its filing or eligibility to file a consolidated return with the plaintiff, Allstate Insurance Company, an insurance company on the calendar year?

Mr. Wilson: Asserted by whom? You said asserted entitlement; you didn't say asserted by whom.

Mr. Davis: Asserted by the Internal Revenue Service.

Mr. Wilson: Where, Chicago or here?

Mr. Davis: Well, I'll strike, delete asserted.

Mr. Wilson: I think he can answer it yes or no.

Mr. Duncan: Yes.

The Witness: I would like to refresh myself. I assume that question was at least an adjunct to the question that they asked for some technical advice.

What I am getting at, I don't recall of having received a request for technical advice as to whether a taxpayer who had filed consolidated returns, or—you see, that wasn't particularly the issue—on a taxpayer who had proceeded to file consolidated returns on some basis in conflict with the regulations. To that extent, this was not the technical advice request, particularly, although the question as to whether a taxpayer had the privilege of filing a consolidated return apparently had to be part of the issue which was raised in the request for technical advice.

By Mr. Davis:

Q. Now, would you review, would you take us through that part of the file dealing with this request for technical advice which relates solely to the aspect of the privilege, asserted privilege of filing a consolidated return?

Mr. Wilson: You are asking, Mr. Davis, for a legal memorandum between the Chief Counsel and the offices and we decline to produce it.

Mr. Davis: I don't know. I am asking for whatever there is there that is not subject to a claim of privilege, and I think the burden is upon you to claim the privilege, whatever it is.

Mr. Rothe: We haven't yet asked to see any documents.

Mr. Wilson: No, you asked him what the documents said.

Mr. Rothe: We want to know what is in the file, what kind of documents and the nature of them.

Mr. Duncan: What happened to your relevancy objection for everything after 1951?

Mr. Rothe: It's still right there, big as life.

Mr. Duncan: There are legal memoranda in the file.

Mr. Wilson: That's right and we are the attorneys here who have custody of this.

Mr. Rothe: There is a question pending to the witness.

Mr. Duncan: He is directed not to answer.

Mr. Wilson: We direct him not to answer.

Mr. Rothe: Let the witness answer however he will.

Mr. Wilson: The witness has been told not to.

Mr. Rothe: But he has to answer.

Mr. Wilson: No, he doesn't.

Mr. Rothe: Are you telling him not to answer anything?

Mr. Duncan: Not go the file; the question was and go through the file.

The Witness: I have been advised by counsel not to answer the question.

Mr. Rothe: Thank you.

By Mr. Davis:

Q. Mr. Swartz, you indicated in the affidavit to which reference has been made here, executed by you on September 22, 1961, that no other formal request for rulings by taxpayers since 1945 along similar lines or involving

essentially the same issue had been located in the files of the Office of Assistant Commissioner, Technical.

Mr. Duncan: That's in the affidavit?

Mr. Davis: I beg your pardon. This is in a stipulation. I'm sorry. Mr. Swartz has not seen this stipulation.

Mr. Duncan: No, he has not, but, of course—yes, go ahead with your question.

Mr. Davis: I withdraw the question. I'm sorry.

By Mr. Davis:

Q. To your knowledge, were there any informal requests, anything other than formal requests, received, and, if so, what would have been their consideration and disposition?

A. I have no knowledge of any informal requests or any discussions; if there were any discussions, they apparently weren't made a matter of record.

Quite often taxpayers will drop in and consult with us as to how a ruling—these are merely oral discussions. Whether there was anything like that, I would have no knowledge. There probably wouldn't even be any record.

Q. When a ruling is published, what is its effect upon other taxpayers? At least, what was its effect in the period 1945 to 1951?

A. I would have to consult the Bulletin as to the effect of published rulings, actually. I believe at that time published rulings were expressed as opinions of the Service and at that time were not to be relied upon necessarily.

Q. Has the frontispiece page in the beginning of each one of the published, bound published volumes of the Bulletin the proper authority for what effect is to be given to a published ruling, would you say?

A. That's an expression of an opinion as to the effect of a ruling, or the treatment to be given a ruling. I believe there are caveats in there with respect to taxpayers or revenue agents not relying on certain rulings unless they are based on the same principles or based on all fours.

They don't constitute closing agreements.

Q. What is the effect—is there any effect upon another taxpayer of the issuance of a ruling that is not published?

A. Insofar as a ruling to a specific taxpayer is concerned, that taxpayer can not take that ruling and assume that it is a ruling to him.

Q. That is, if it's to somebody else?

A. Right. The taxpayer who receives the ruling is the taxpayer to whom the ruling applies. Another taxpayer cannot assume that that ruling is applicable to his situation or can be relied on by him with respect to that particular ruling to that particular taxpayer.

This, however, does not mean that this has not become a procedure of practice or position of the National Office with respect to answering similar or identical questions, if requested by the taxpayer; in fact, it indicates that we would give the same answer to other taxpayers, unless some position has been changed.

Q. What indicates this, now?

A. In my opinion, the fact that the position that was taken with respect to the answer to these requests for rulings, having been put in the Precedent File, that any other taxpayer requesting permission to do the same thing that these taxpayers were permitted to do would have received the same favorable response, at least up to now, because no position has been taken contrary to that position and these precedents have not been removed from the files.

Q. Now these precedents would be limited to the facts set forth in the request for a letter ruling and the circumstances summarized in the ruling letter itself.

A. The principles set forth therein. The mere fact that the dates might be different wouldn't make any difference, but the principles set forth therein, and this is the precedent that is used, the principles set forth in those files.

Q. I believe you have testified previously, and I wondered if you would care to reconsider whether there is any basic difference between—under the applicable Internal Revenue or applicable Treasury Regulations and relevant statutes, whether there is any basic difference between the conformity of a newly acquired insurance company subsidiary with the fiscal year parent in the filing of a consolidated return and—

Mr. Duncan: This is getting to be a long question, Mr. Davis.

The Witness: It's a long question; it's difficult for me to follow this question.

Mr. Duncan: Are you asking him his opinion as an expert?

Mr. Davis: No, he has read the ruling, he has said that he felt that there was something which would be applicable to every taxpayer similarly situated. I am trying to see what is his concept of similar situations.

Mr. Duncan: All right. I don't disagree with you, but I think it would be helpful if you would make your question just a bit shorter.

By Mr. Davis:

Q. All right. I'll be glad to try.

Is a similar situation entailed, in your opinion, in the problems of adapting a newly acquired insurance company to the filing of a consolidated return with a fiscal year

parent as with the conformity of the fiscal year parent with the calendar year subsidiary with which it has been affiliated for some prior period?

Mr. Duncan: Probably Mr. Swartz—

The Witness: I think I get the question. However, my response goes to the fact that we answer questions in both of those situations, situations which had affiliates or where the insurance company was acquired after the fiscal year of the parent and then these cases where they acquired the insurance companies before the period end of the parent.

In other words, what I am saying is in my opinion the position, policy that has been established, or that is set forth in the rulings that were issued and became part of our files would indicate to me that a parent who had had an insurance company and had it for some time would be accorded the same treatment that would have been accorded the taxpayers that were involved in these rulings.

By Mr. Davis:

Q. All right.

On what do you base that opinion in the letter rulings that were issued prior to December 31, 1950; namely, Exhibits 1, 2, 3, and 4?

A. In ruling No. 4 the insurance company was acquired prior to the end of the fiscal year parent, it wasn't acquired after the fiscal year of the parent, which would base it on the principles, as I understand it, and the assumption is that the Commissioner was trying to find a way to allow taxpayers to file a consolidated return in accordance with the intent of Congress, even though there was a conflict in the regulations where one of the affiliates was an insurance company. The way that was handled was merely to have the parent, by reason of, depending upon the facts, file short period years until it had established its conformity with the insurance company, at which time they could go on and file consolidated returns.

This whole practice, as I understand, was with the knowledge there was a conflict in the regulations. This is why the taxpayers asked the question, because of the apparent conflict in the regulations.

The Commissioner was aware of the conflict in the regulations, because of the fact that he thought that Congress had intended, to the extent practicable, for the Commissioner to allow taxpayers to file consolidated returns, that he had established the position under which this could be done in any case, whether or not this was a new insurance company, acquired insurance company, an old insurance company acquired before the date of the fiscal year, or acquired after the date of the fiscal year. I am talking now about the principle of what the Commissioner was attempting to do in connection with these rulings.

Q. You base this opinion on your examination of the ruling letters or upon what other information?

A. I base this upon what I gather from the fact that these ruling letters were issued, plus the documents which were considered here where it was recognized in the request and recognized that there was this conflict in the regulations, and that the Commissioner could very well have said, "There is a conflict in the regulations", or, "I'm going to adopt the hard-nosed position and deny anyone filing consolidated returns". He took the other position and found a way out, the aim being to allow these corporations to file consolidated returns, and he found an administrative way which was acceptable and adopted it, and I assume that, in my opinion, this became a practice which was adopted and would have been applied to all other taxpayers who were seeking the same ruling, asking for permission to do the same thing, just as the other taxpayers did and just as these other taxpayers were granted permission to do so, even to the extent, in one case, of filing two consolidated returns in order to conform.

Q. Yes. Now, this opinion is based upon the ruling letters and your examination of them. You, however, did not have anything to do with the actual issuance of the ruling letters; is that correct?

A. That is correct. I did not participate in the original issuance of these rulings.

Q. All right.

Does your office ever change its position on rulings, even though there is no change in the law or the regulations?

A. Oh, yes. When it changes its position, however, any precedents on which the previous position relied on are removed from the Precedent File and the new position placed therein.

Q. When you were executing the affidavit, did you at that time rely on your own personal reading of the files, or were you—(Pause)

Mr. Duncan: I'm sorry, Mr. Davis. Go ahead.

By Mr. Davis:

Q. Were you relying upon your own personal reading of the ruling letters and the requests for rulings or had you had an opportunity to read them ahead of time?

A. I had had an opportunity to read these rulings, plus the knowledge of having had considered this issue at one or other. I don't recall now when it was, but I know that I had discussed this particular issue when I was Director of the Tax Rulings Division.

Q. Did you have occasion to look into these files prior to the signing of the affidavit relating to the circumstances under which the Commissioner would grant permission to the parent on a fiscal year to change to a calendar year?

A. My affidavit was based on the reading of the facts contained in the ruling letter.

Q. You mean exhibits 1 to 7?

A. I don't know if 7 was in there or not, 1 through 6.

Q. All right.

But as you went hrough those files there was nothing, with perhaps one exception there is no reference to the granting of, the circumstances or conditions under which the Commissioner would grant the consent to the fiscal year parent to change to a calendar year; isn't that right?

Mr. Duncan: I believe he said that the matter had been checked out, Mr. Davis.

The Witness: At the time that this was being discussed with Mr. Levine—

By Mr. Davis;

Q. Did you read any of those?

A. Let me tell you what I did read. I read the ruling letters and at the time that I was reading these ruling letters I noticed that in some of them at least it said that if you secure permission to change your accounting period you will be granted, and I asked Mr. Levine, well, this is all fine, but was permission ever granted in any of these cases to change the accounting period, or were any requests made?

He, at that point, then checked the files for me and told me that there had been situations which followed up these ruling letters in which requests had been received to change to this period in conformity with suggestions set forth in the ruling letter; that permission had been granted and later on—I don't know what period it was, but that returns had been filed on that basis.

Q. Was there any ever denied; do you know?

A. There were none insofar as I knew that had been denied. There may have been one in which no permission had been requested.

Q. Was any variation, any dispensation as to the grounds that would be recognized for changing?

A. Of my own personal knowledge, I only have knowledge of the fact that in these particular rulings the requests—in some of them, the requests have been made, and that permission had been granted. I did not inspect those files.

Q. Do you know whether there was ever any formal determination of policy which might have been made either by the Commissioner of Internal Revenue or the Assistant Commissioner or anyone in a policymaking position which would support the proposition set forth in the last paragraph on page 2 of Exhibit 5 that this is the policy?

A. No. No, I know of none of my own personal knowledge.

Q. What is your concept of an administrative practice?

A. By administrative practice I understand that once a position has been adopted and set forth in a ruling letter that this, particularly if it is put in the Precedent File, it is always the practice to follow that ruling unless that particular ruling, if those are the facts involved, unless some consideration is made that we are changing that position.

An administrative practice, or policy, or position might be one which we have followed issuing rulings on the basis of those concepts without any reconsideration or backtracking or saying we were probably wrong, we ought to change our mind or change our position here and not proceed any longer to engage in this practice in which we have been engaging.

Q. Have you ever had occasion to define the term before as used here in the Internal Revenue Service?

A. I have never particularly had to define the word practice.

Q. Administrative practice?

A. Not particularly, no; not as administrative practice. I was going by the position, this is what the Internal Revenue Service has been doing, it has been their procedure, their policy, their position. Practice is as good a word, as far as I know. The practice has been to issue rulings along this line and there has not been any change in that practice.

Q. This is not a scientific term or term of art then?

Mr. Wilson: If you know.

The Witness: As far as I know it isn't.

By Mr. Davis:

Q. So that we can know just what the practice, in this description, of how an insurance company and a fiscal year parent might proceed to conform, would there be any way that a fiscal year parent and insurance subsidiary could file a consolidated return for the parent's fiscal year merely by having the parent notify the Commissioner that it was changing to a calendar year accounting period immediately thereafter?

In explanation of this question, would there not first have had to be filed a request to change on the part of the parent on form 1128, in accordance with the regulations, and consideration and consent by the Commissioner?

A. I'm not so sure about that. I was reading through the old regulations and some of the new regulations and I think there is a situation in which merely by notifying the Commissioner in some circumstances that an affiliated group can file a return without getting a request; they can merely notify, the taxpayer.

Q. Isn't that a case in which the subsidiary is changing to the year of the parent?

A. Changing to the parent's, right, merely notification.

Q. Otherwise, is it your understanding of these rulings that they would in every case require first that the parent apply for and obtain the consent of the Commissioner to change from the fiscal year to the calendar year?

A. I think we have so stated in these particular rulings.

Q. Yes.

Mr. Davis: Thank you.

Further Examination on Behalf of Defendant.

By Mr. Duncan:

Q. I would like you to refer to defendant's Exhibit 1 or '44, a ruling, and I believe it was your testimony that despite the reference in the ruling to the 1941 ruling we have not been able to locate that ruling of 1941?

A. Yes, I think that's right.

Q. Now this ruling revokes the 1941 ruling, does it not?

A. Yes, it does.

Q. This ruling was in the Precedent File?

A. The February 14, 1944 ruling which is Defendant's Exhibit 1 is in the Precedent File, yes, sir.

Q. When a ruling is revoked, what happens to the file?

A. When a ruling is revoked, a specific ruling to a taxpayer's request?

Q. Yes, by another ruling; what happens to the original ruling, the revoked ruling?

A. If it's our file, if it hasn't been sent to the Collector's Office, or it hasn't been destroyed, it's usually retained. We have a procedure of destroying some of our correspondence that is not in the Precedent File. I don't know what dates this correspondence was destroyed, but from time to time rulings that are not placed in the Precedent File because of their volume are destroyed, from time to time.

Q. When a ruling is revoked, is removed from the Precedent File—

A. Oh, if the ruling which is revoked had been a Precedent and was in the Precedent file, it, of course, would be removed from the Precedent File. If it was just a ruling which had not been put in the Precedent File, the Precedent File, the original, the original ruling no longer being a precedent or no longer even being adhered to, the chances are it would just remain in the general files or wherever the files were and probably eventually destroyed.

Q. You were questioned with respect to how a document, how a particular ruling got into the Precedent File, and I believe you testified going through these various files with respect to a form on the lefthand side which would have various blocks that would be checked—

A. Right.

Q. —and would have reasons for digesting. Now, when you referred to digesting, would you mean digesting for the Precedent File?

A. Oh, yes, they would not digest unless they put it in the Precedent File.

Q. I believe you identified a number of these rulings, several of them as having been initialed by Chief Counsel. Let's run through them here and see. There are 1944, the copy we have does not have initials, does it?

A. No, this exhibit does not have.

Q. Referring to the file which you referred to earlier, does the file indicate whether this document went to Chief Counsel or not?

A. Yes, this particular one went to Chief Counsel, yes.

Q. Now referring you to Defendant's Exhibit 2, do the initials on that exhibit indicate that that document was approved by Chief Counsel?

A. Yes.

Q. Now, referring you to Defendant's Exhibit 4, do the initials on that document indicate that it was sent to Chief Counsel?

A. Yes, sir.

Q. And approved by him?

A. Yes.

Q. Would approval by the Chief Counsel be an influencing factor as to whether a document would be digested and put into the Precedent File?

A. It would be a factor in digesting it and putting it into the Precedent File, and—well, yes.

Q. You were questioned with respect to the distribution of rulings to the field under a procedure entitled "Confidential Unpublished Rulings". Speaking from your recollection and experience as a Revenue Agent, did the field office and the people working in the field office consider these rulings distributed to the field offices of importance?

A. Yes, we considered them important to the extent of being able to research to see what the line of thinking was if we had a situation that involved that type of issue.

I might say that we had other documents that we referred to also, there were GCMs, there were various other internal documents, other than CURs, which were put in the file and these were utilized to refer to with respect to the reasoning or the line of thinking in connection with this issue. Although, as I said before, we were not to cite them or quote them as being the reason we were doing it.

We would locate files, see what the line of thinking was or the reasoning and then we would adopt it in arguments; rather than saying the reason I am doing this is because I found a document, the reason I am doing this is because, based on the document itself, I have adopted this principle and am using it in this particular case.

Q. Was the distribution of these rulings to field offices an established procedure when you were a Revenue Agent?

A. I would assume so. Of course, I wasn't in the National Office, which at that time was doing the distribution, but certainly from time to time new documents would come in with these little card indexes which would be put in the index files, which we would use to locate the actual document.

Q. Speaking from your experience and recollection as a Revenue Agent working in the field office, were these documents considered by the agents as binding upon them?

Mr. Davis: I object to this question, if you please. Mr. Swartz is not qualified to state what other revenue agents may have considered to be binding on them. If he wishes to testify as to what he did or maybe how he used the CURs.

By Mr. Duncan:

Q. Tell us what you did, how you regarded these and why?

A. Well, as I explained, these, when we ran into a question, an issue that was involved that couldn't readily be answered by looking at the law and the regulations and published opinions, before we proceeded any further, let's say, to request technical advice or to go to our supervisors or people at the time who had more technical knowhow than we had, we would exhaust our other avenues such as consulting the index file in our office.

That index file was filed by subjects. I don't know how, whether a librarian did it, but we could find family partnerships, or we could find consolidated returns, and we could find traveling expenses and so forth.

In there, under that index would be a number of cards, there might be 25 cards, there might be only 2, but further on the card we would get a brief explanation or digest of what this particular ruling contained, what this particular document contained. If I took it from the digest card that there might be something in this document that could be used in connection with my issue, we went further and pulled the particular document out of the file, which was by name, and read it to see whether or not the reasoning therein could be used in relation to solving the problem that I had before me.

Mr. Davis: When the witness is using the term "we", you mean, really, that's the way you operated?

The Witness: That's the way I operated, and, of course, I saw many other revenue agents and also conferees at that time consult that file, and I assume they were using it, if they consulted it.

Mr. Davis: Thank you.

By Mr. Duncan:

Q. Mr. Swartz—

A. As a matter of fact, in the New York office this file was kept in and by the conference section, available to reviewers, revenue agents and conferees.

Q. Mr. Swartz, you testified with respect to the amount of reliance or lack of reliance which a non-receiver of a private letter ruling could give to that letter ruling. Would you explain that? Why does the Service not allow non-taxpayers, or non-receivers to rely upon this letter ruling?

A. This is just a long practice. First of all, with respect to letter rulings, as I say, other than those that are required by law or by regulation, they are primarily opinions or rulings issued by the Commissioner of Internal Revenue with respect to the facts presented in that particular case with respect to that particular taxpayer.

Now, in order to revoke a position, in other words, if we issue a ruling which we find later that we think is wrong or should not have been issued or that we want to change our position, the question then would be whether or not the taxpayer in reliance on a letter that he had received from the Commissioner and consummated the transaction could later on be penalized retroactively because the Commissioner had up and changed his mind.

A policy, a long-established policy of the Commissioner's has been established that with respect to a taxpayer who had received a ruling and who had consummated a transaction in reliance on that ruling to his detriment should not be penalized retroactively, if the Commissioner changed his mind. To that extent, Congress had given him authority under what is now Section 7805-B in the Internal Revenue Code to apply a ruling non-retroactively.

However, taxpayers were cautioned and I might say for the first time, this was announced, however, in 1954, that in general taxpayers who received rulings could rely on them and that in general the Commissioner, if he revoked the ruling, would not revoke it retroactively. In effect, saying that he would apply Section 7805-B to that particular situation.

However, the Commissioner did not want to be put in the position of issuing private rulings in an area which he did not publish, and assume that that was to become necessarily the nationwide position with respect to the facts in that particular case to all taxpayers. We wanted to consider the facts in a particular case.

The point being that in applying 7805-B, with respect to a ruling, he couldn't very well say that he was applying it to every taxpayer who read this ruling over the taxpayer's shoulder. That was primarily the reason.

However, quite often taxpayers have a knowledge of a ruling issued to another taxpayer and would request a

similar ruling of the Commissioner in order to get a document in his hands that would have the same effect on him.

Q. Frankly, there's a case up here in the 1953 ruling—

Mr. Rothe: Are you leading again, Mr. Duncan?

By Mr. Duncan:

Q. Is there a case of this here?

A. Yes, in my opinion I would think so. I would say that based on my analysis of the policy and practice that the Commissioner was engaging in, in connection with these problems that were presented to him in connection with this conflict in the regulations, it would indicate that any taxpayer during that period and up until now would have been granted the same privilege.

I say that because, had we changed our position with respect to granting this kind of a privilege, we would have removed these rulings from the Precedent File.

Mr. Duncan: That's it.

Further Examination on Behalf of Plaintiff.

By Mr. Davis:

Q. You announced or you stated the policy had been announced in 1954 with respect to reliance to be placed on the published rulings. What was the policy prior to that time?

A. The policy prior to that time had not been announced; there was never any published position with respect to dignity of a private ruling other than a closing agreement.

However, we had researched this problem in connection with adopting a policy in 1954 with respect to this number of situations in which a Commissioner had or a Deputy Commissioner or where a ruling issued by a proper person in Washington on which a taxpayer had relied to his detriment had been revoked, and we found, at least with re-

spect to the files that we could find going a considerable way back, that it was the continued practice of the Commissioner not to revoke a ruling to a taxpayer retroactively where all the facts were set forth and the transaction was consummated in accordance with the manner in which he had set forth in his request.

Q. If a ruling was issued and was not included in the Precedent File, did its issuance, in your opinion, constitute a practice?

A. I would say that certainly a ruling, whether it was in the Precedent File or not, would normally be followed, would normally be followed with respect to the facts in that particular case, unless the man who is considering the ruling felt that the original ruling was wrong.

There was nothing to prevent someone considering an issue with respect to which a previous position had been taken from taking issue with that position and considering whether or not we ought to change our position.

Q. Was the ruling letter dated December 11, 1941, referred to in Defendant's Exhibit No. 1, did that constitute practice between 1941 and 1944?

A. That I do not know.

Q. During that period of time it was applicable with respect to this particular taxpayer, wasn't it?

A. Oh, yes.

I presume that if there had been other situations that there might have been similar rulings issued until it was decided that we were changing our position on that.

Q. So that in this whole area of consolidated returns between the fiscal year parent and the calendar year subsidiary—

A. And an insurance company subsidiary.

Q. —and an insurance company calendar year subsidiary, yes, (continuing) there were but four letter rulings

to the best of your knowledge and research in your searching of your files here during the period from 1944 until 1951; is that correct?

A. That's what I've been told. I didn't personally go through these files, but the people that I told to research the files have indicated that this is so.

Mr. Duncan: Four, I think there are seven.

The Witness: Up through '50.

Mr. Duncan: I'm sorry.

Mr. Davis: Thank you.

I have read the foregoing pages, 1 through 195, inclusive, which contain a correct transcript of answers made by me to the questions therein recorded.

/s/ Harold L. Swartz

CERTIFICATE OF NOTARY PUBLIC

I, Jo Ann Withers, the officer before whom the foregoing deposition was taken, do hereby certify that the witness whose testimony appears in the foregoing deposition was duly sworn by me; that the testimony of said witness was taken by me stenographically and thereafter reduced to typewriting under my direction; and said deposition is a true record of the testimony given by said witness; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this deposition was taken, and further that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of the action.

/s/ Jo Ann Withers
Notary Public in and for
the District of Columbia

My commission expires February 14, 1965

DEFENDANT'S EXHIBIT 1

February 14, 1944

[*]Insurance Company
[ ]

Gentlemen:

In a letter dated December 11, 1941 addressed to the collector of internal revenue at [ ], a copy of which was furnished for your files, you were granted permission to change your taxable year from a calendar year to a fiscal year ending on November 30, effective as of November 30, 1941, in order that you might join with your parent company in filing a consolidated return.

In accordance with the permission granted a consolidated return was filed by your parent company, the [ ] Corporation, for its fiscal year ended November 30, 1941 including therein the income of your corporation. The attention of the Bureau has now been called to the fact that your corporation is a stock casualty insurance company taxable under section 204 of the Internal Revenue Code. In view of the fact that the income tax regulations have uniformly construed section 204 of the Internal Reveneu Code and the corresponding sections of prior revenue acts as requiring insurance companies taxable under those sections to file their returns on a calendar year basis, permission to change to a fiscal year basis should not have been granted in your case.

However, in view of the fact that a change was granted and that consolidated returns were filed pursuant to the authority so granted, consolidated returns will be accepted for the fiscal years ended November 30, 1941, 1942 and

* Indicates deletion of name of taxpayer or other confidential matter.

1943, and the fiscal year ending November 30, 1944. Subsequent to November 30, 1944 consolidated returns will not be accepted unless such returns are filed on the calendar year basis. If the consolidated group desires to change to the calendar year basis effective as of December 31, 1944 application should be filed by the parent company on Form 1128 in accordance with the provisions of section 29.48-1 of Regulations 111.

In the event that the consolidated group, except for your corporation, desires to remain on the fiscal year basis each of the other corporations involved will be permitted to file individual returns on the basis of a fiscal year ending November 30, 1945 inasmuch as the election to file consolidated returns was made pursuant to the ruling from this office permitting a change in your taxable year.

2—[ ] Insurance Company—

In view of the above Bureau letter dated December 11, 1941 is revoked insofar as it pertains to any taxable year beginning after November 30, 1944 and you will be required to file your returns on the calendar year basis after that date. If the consolidated group obtains permission to change to the calendar year basis, a consolidated return will be required for the month of December 1944. In the event that the remainder of the group elect to remain on the fiscal year basis, your company will be required to file a separate return for the month of December 1944 in order to again place you on the calendar year basis.

By direction of the Commissioner.

Very truly yours,

/s/ Norman D. Cann,
Deputy Commissioner.

DEFENDANT'S EXHIBIT 2.

May 26, 1945

[ ]
[ ]

Received May 30, 1945
Bureau Information & Rulings Section
Practice & Procedure Division
Income Tax Unit

Gentlemen:

Reference is made to your letter of April 17, 1945, regarding the filing of consolidated returns upon the acquisition by a parent corporation on a fiscal year basis of an insurance company subject to tax under section 204 of the Internal Revenue Code which is required in accordance with the applicable regulations to report its income and deductions on the calendar year basis.

Your client, [ ] Inc., et al. and its subsidiary, [ ] Corporation, file consolidated income and excess profits tax returns on the basis of a fiscal year ending June 30. [ ] Insurance Company, a stock corporation which is taxable under the provisions of section 204 of the Internal Revenue Code, files its returns on the basis of the calendar year as required by the regulations. It is proposed that [ ] Inc., will acquire sufficient stock of [ ] Fire Insurance Company to qualify it as a member of the affiliated group. You make several inquiries which are dependent upon whether the calendar year or fiscal year must be adopted for the purpose of filing consolidated returns.

Section 23.14 of Regulations 104 provides that the taxable year of an affiliated group which makes a consolidated income tax return shall be the same as the taxable year of the common parent corporation; and, upon having elected to file consolidated returns, each subsidiary corporation

shall, not later than the close of the first consolidated income tax taxable year ending thereafter, adopt an annual accounting period, fiscal year or calendar year as the case may be, in conformity with that of the common parent. Section 33.14 of Regulations 110 contains a similar provision relating to the filing of consolidated excess profits tax returns.

As pointed out in your letter, section 29.204-1 of Regulations 111 requires that the returns under section 204 shall be made on the basis of a calendar year. The reason given for this provision is that section 204 of the Code provides that the underwriting and investment exhibit of the annual

statement approved by the National Convention of Insurance Commissions shall be the basis for computing gross income, and that such annual statement is rendered on the calendar year basis. In the light of these reasons and in view of the fact that the provision requiring the filing of calendar year returns is specific, it is held that calendar year returns are required to be filed by insurance companies taxable under section 204 of the Internal Revenue Code and that [ ] Fire Insurance Company would not be permitted to report its income on the basis of a fiscal year ending June 30, for the purpose of filing consolidated returns.

Upon the assumption that permission would be granted to [ ] Inc., and [ ] Corporation to change their accounting periods to the calendar year as of July 1, 1945, and that the former corporation would acquire between July 1 and July 30, 1945 the required amount of the stock of the [ ] Fire Insurance Company to qualify the latter company as an affiliated corporation, you request

advice as to whether such insurance company may join with the other two affiliated corporations in filing consolidated income and excess profits tax returns for the period July 1 to December 31, 1945.

It is held that, if [ ] Inc. and [ ] Corporation secure permission and change to a calendar year basis effective December 31, 1945 and if [ ] Fire Insurance Company becomes a member of the affiliated group between July 1 and July 30, 1945, consolidated returns may be filed for the taxable period July 1, 1945 to December 31, 1945. The consolidated returns would include the income of the two non-insurance companies for the entire taxable period and the income of the insurance company from the date of acquisition to December 31, 1945, or, if the option provided by section 23.13(f) of Regulations 104 and section 33.13(f) of Regulations 110 to disregard the period of less than 30 days during which it was not a member of the group is exercised by such company, its income for the entire taxable period of the group. The insurance company would be required to file a separate return for the period in 1945 with respect to which its income is not included in the consolidated return. For the purpose of determining the income of the insurance company to be included in the consolidated return and in its separate return your attention is invited to section 23.32 of Regulations 104 and section 33.32 of Regulations 110.

In view of the conclusions reached herein, it is not believed necessary to mention the alternative questions contained in your letter.

Very truly yours,

/s/ William T. Sherwood,
Acting Commissioner.

DEFENDANT'S EXHIBIT 2-A

April 17, 1945

Mr. Norman D. Cann
Deputy Commissioner of Internal Revenue
Income Tax Unit
Bureau of Internal Revenue
Washington, D.C.

Attention: Mr. C. P. Suman
Head, Practice and Procedure
Division

Sir:

A question has arisen concerning the application of the Federal income and excess profits tax regulations to returns permitted and/or required to be filed by corporations, members of an affiliated group, where a subsidiary corporation, during its taxable year (determined without regard to the affiliation), becomes a member of the affiliated group.

One of our clients, [ ] Inc., and its subsidiary, [ ] Corp., which are affiliated corporations, file, under the provisions of Section 141 of the Code, consolidated Federal income and excess profits tax returns on the basis of a fiscal year ended June 30.

[ ] Fire Insurance Co., a stock corporation, taxable under the provisions of Section 204 of the Code, files its Federal income and excess profits tax returns on the basis of the calendar year as is required by Section 29.204-1, Regulations 111.

It is proposed by [ ] that between July 1 and July 30, 1945, it shall acquire the requisite amount of stock of [ ] to qualify the latter as a member of the affiliated group.

Under the provisions of Section 23.14, Regulations 104, and Section 33.14, Regulations 112, [ ] will be required to take the same taxable year as the parent corporation, which in this case is a fiscal year. Under the provisions of Section 29.204-1, Regulations 111, however, [ ] must report its income on a calendar year basis.

1. Assuming that the stock acquisition occurs in July, 1945, as above proposed, will [ ] be permitted or required in the filing of a consolidated return to report its income on the basis of a fiscal year ended June 30?

2. Assuming that [ ] must take the fiscal year basis of its parent, will [ ] report its income for the period January 1 to June 30, 1945 in a separate return under Section 23.13(g), Regulations 104, and Section 33.13(g), Regulations 112?

3. Assuming that, as we have been orally advised by your office, [ ] is not permitted to report its income on the basis of a fiscal year; that permission would be granted by the Commissioner to [ ] and [ ] to change their accounting periods to the calendar year basis as of July 1, 1945; and further, that [ ] acquired, between July 1 and July 30, 1945, the requisite amount of [ ] stock to qualify the latter as an affiliated corporation, the following questions are posed:

2—[ ]

4. May [ ] as an affiliated group, file consolidated income and excess profits tax returns for the period July 1 to December 31, 1945?

5. If not, may the first two corporations file consolidated returns for income and excess profits tax purposes for such period?

6. would the requirement that [ ] file a separate return for the period January 1, 1945 to June 30, 1945,

under Section 23.13(g), Regulations 104, and Section 33.13 (g), Regulations 112, be in any way inconsistent with the requirements of Section 29.204-1, Regulations 111, that the return shall be made on the basis of a calendar year?

In connection with the question last listed, it will be noted that the first return of a stock fire insurance company or its final return in the year of dissolution, though encompassing a period of less than twelve months, nevertheless appears to meet the requirements of Section 29.204-1, above.

Since the precise time at which [ ] will acquire the requisite amount of [ ] stock will depend upon your ruling herein together with securing, before July 30, 1945, permission from the Commissioner, if necessary, for [ ] to change their method of accounting to the calendar year basis, it is respectfully requested that a ruling be issued at your earliest convenience.

Very truly yours,

/s/ B. Leidendorff

DEFENDANT'S EXHIBIT 3.

September 12, 1945

[ ] Corporation
[ ]

Attention: [ ]

Gentlemen:

Reference is made to your letter of August 9, 1945, regarding the filing of consolidated returns upon the acquisition by a parent corporation on a fiscal year basis of an insurance company subject to tax under section 204 of the Internal Revenue Code which is required in accordance with the regulations to report its income and deductions on the calendar year basis.

Your corporation and its subsidiaries are engaged in the automobile financing, small loan and accounts receivable financing business. Since 1940 the corporations have filed their income tax returns upon the basis of a fiscal year ending September 30 since this period closely represents the natural business year of companies in the automobile industry. Your corporation and all of the subsidiaries which are more than 95 percent owned have filed consolidated income and excess profits tax returns for the past three years and intend to continue filing consolidated returns. In May 1945 your corporation acquired approximately 65 percent of the capital stock of [ ] Insurance Company, a corporation engaged in underwriting fire and allied lines of insurance, and in connection with this purchase it agreed to offer all other shareholders the same price, $10.00 per share, for their stock in such corporation. At the present time your corporation owns approximately 93 percent of the outstanding capital stock of the insurance company and it many ultimately acquire 95 percent or even 100 percent of the stock.

The insurance company files its income tax returns on the calendar year basis. Its accounts will be audited annually as of September 30, however, in order to enable

their consolidation with the accounts of your corporation and its other subsidiaries. You point out the provisions of section 141(a) of the Internal Revenue Code to the effect that the making of consolidated returns shall be upon the condition that all corporations which are members of the affiliated group consent to all the consolidated income and excess profits tax regulations. You also call attention to the provisions of section 29.204-1 of Regulations 111 providing that the returns under section 204 shall be made on

the basis of the calendar year since the underwriting and investment exhibit of the annual statement, approved by the National Convention of Insurance Commissioners, shall be the basis for computing gross income and since such annual statement is rendered on the calendar year basis.

You point out the complexities involved in changing the closing date of a group of some 25 corporations for Federal income tax purposes as well as for State taxes and other reports. It is your understanding that the calendar year closing for insurance companies is desired in order to facilitate administration and examination of returns. You state that an independent audit of the insurance company's books on a September 30 basis would be available each year and that you would be willing to prepare a completely filled out annual statement for each year on a September 30 basis. You request advice as to whether it will be permissible under these conditions for your corporation and all of its subsidiaries including the insurance company to file consolidated income and excess profits tax returns on the basis of a fiscal year ending September 30.

Section 23.14 of Regulations 104 provides that the taxable year of an affiliated group which makes a consolidated income tax return shall be the same as the taxable year of the common parent corporation; and, upon having elected to file consolidated returns, each subsidiary corporation shall, not later than the close of the first consolidated income tax taxable year ending thereafter, adopt an annual accounting period, fiscal year or calendar year as the case may be, in conformity with that of the common parent. As pointed out in your letter, section 29.204-1 of Regulations 111 provides that the returns under section 204 shall be made on the basis of a calendar year.

3—[ ] Corporation

This office appreciates the burden involved in connection with the change of an accounting period from a fiscal year to that of a calendar year under the circumstances cited in your letter. However, in view of specific provision of the regulations requiring the filing of calendar year returns and in view of certain other considerations, it is deemed administratively inadvisable to permit the affiliated group in question to report its income on the basis of a fiscal year ending September 30 for the purpose of filing consolidated returns.

Very truly yours,
/s/ Norman D. Cann,
Deputy Commissioner.

DEFENDANT'S EXHIBIT 4.

February 5, 1947.

Received February 19, 1947
Bureau Information & Rulings Section
Practice & Procedure Division
Income Tax Unit

[ ]
[ ]

Gentlemen:

Reference is made to your letter of October 15, 1946, in which you request on behalf of your client [ ], Inc. et al. a reconsideration of your letter of September 25, 1946, regarding the procedure to be followed in filing a consolidated income tax return and a consolidated excess profits tax return for the fiscal year ended September 30, 1946, by an affiliated group which acquired complete ownership of [ ] Fire and Marine Insurance Company as of July 1, 1946.

The [ ] Fire and Marine Insurance Company has been filing its returns on the calendar year basis as required by the provisions of section 29.204-1 of Regulations 111. It is proposed that (1) the affiliated group will file consolidated returns for its year ended September 30, 1946, including therein the income of the fire insurance company from July 1, 1946, to September 30, 1946; (2) the fire insurance company will file a separate return for the period January 1, 1946, to June 30, 1946, but will remain on the calendar year basis; (3) the parent company and the subsidiaries now on the fiscal year basis will make application to change to the calendar year basis effective December 31, 1946; and (4) a consolidated income tax return will be filed for the period October 1, 1946, to December 31, 1946, including the income of the fire insurance company for such period. You request approval of such procedure.

Section 23.14 of Regulations 104 provides that the taxable year of an affiliated group which makes a consolidated income tax return shall be the same as the taxable year of the common parent corporation; and, upon having elected to file consolidated returns, each subsidiary corporation shall, not later than the close of the first consolidated income tax taxable year ending thereafter, adopt an annual accounting period, fiscal year or calendar year as the case may be, in conformity with that of the common parent. Section 33.14 of Regulations 110 contains a similar provision relating to the filing of consolidated excess profits tax returns.

As pointed out in your letter, section 29.204-1 of Regulations 111 requires that the returns under section 204 shall be made on the basis of a calendar year. The reason given for this provision is that section 204 of the Code

2—[ ]

states that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income, and that such annual statement is rendered on the calendar year basis. In the instant case, therefore, the parent corporation and its other subsidiary corporations will be required for the purpose of filing consolidated returns to adopt a calendar year accounting period in conformity with that of the fire insurance company.

If [ ] Inc., and its subsidiaries change to a calendar year basis effective December 31, 1946, it is held that consolidated income and excess profits tax returns may be filed for the fiscal year ended September 30, 1946 including the income of [ ] Fire and Marine Insurance Company for the period July 1, 1946, to September 30, 1946, and a consolidated income tax return may be filed for the period October 1, 1946, to December 31, 1946, including the income of the fire insurance company for such period. The income of the fire insurance company to be included in the consolidated returns should be computed on the basis of its income as shown by its books if the accounts are so kept that the income for the periods can be clearly and accurately determined, but if the accounts are not so kept, the income to be included in the consolidated returns should be computed on the basis of that proportion of its income for the full period covered by its books which the number of days for which its income is included in the consolidated return bears to the number of days in the full period covered by its books. (See section 23.32 of Regulations 104 and section 33.32 of Regulations 110.)

The fire insurance company will be required to file a separate income tax return for the period January 1, 1946, to June 30, 1946. (Section 23.13(g) of Regulations 104.)

The ruling contained in office letter of October 10, 1946, is modified to the extent inconsistent with the foregoing.

Very truly yours,

/s/ Joseph D. Nunan, Jr.,
Commissioner

DEFENDANT'S EXHIBIT 4-A

September 25, 1946

The Commissioner of Internal Revenue
Washington, D.C.

Att: Practice and Procedure Division
Re: Special ruling for [ ]
Inc. and subsidiaries

Gentlemen:

Our client, [ ] Inc. and its subsidiaries have requested us to obtain a special ruling concerning the proper procedure to follow in the filing of consolidated income and excess profits tax returns. We are attaching hereto a power of attorney authorizing the writer to represent these companies in this matter and we would appreciate your directing your reply to us at the earliest opportunity.

The facts are as follows:

[ ] Inc. is the parent corporation of an affiliated group which filed a consolidated income tax return and a consolidated excess profits tax return for the fiscal year ended September 30, 1945. As of July 1, 1946 this parent corporation acquired complete stock ownership of the [ ] Fire and Marine Insurance Company. For the purpose of filing a consolidated income tax return, this insurance company is an includible corporation (Section 141 Internal Revenue Code). According to the Regulations (Regulations 111 Section 29.204-1), such an insurance company must employ the calendar year as

its accounting period for income tax purposes. Thus, the parent company and its other subsidiaries are on a fiscal year basis, its taxable year ending September 30, 1946, while the insurance company is required by law to use the calendar year. This insurance company, as an includible corporation, must be included in the consolidated income tax return which the parent corporation intends to file for the fiscal year ending September 30, 1946 (Regulations 111, Section 29.141-1(c)).

There is therefore an apparent conflict in this set of facts so that a special ruling is hereby requested indicating the proper procedure to follow for this consolidated group.

After reviewing the situation carefully with one of your representatives in Washington, we consider the following procedure to be proper and we respectfully request your permission to proceed as follows:

1. [ ] Fire and Marine Insurance Company will remain on a calendar year accounting period.

2. For the purpose of filing a consolidated income tax return with the affiliated group to which it belongs, the insurance company will be included in the consolidated return to the extent that a proportionate part of its annual income for 1946, corresponding to the number of days of its affiliation with the group during the taxable year, shall be included in the income of the group.

3. [ ] Fire and Marine Insurance Company will file a separate income tax return for the period from January 1, 1946 to June 30, 1946, constituting the period before it became a member of the affiliated group.

4. [ ] Inc. and its subsidiaries will request approval of the Commissioner to change their accounting periods to the calendar year. A consolidated income tax return will then be filed for the remaining part of 1946,

namely October 1st through December 31st, 1946. Included therein would be a proportionate part of the income for 1946 of the [ ] Fire and Marine Insurance Company.

5. After this short period consolidated return, the calendar year will be the taxable year for all members of the group and the consolidated return for 1947 will include the income of all subsidiaries, including the insurance company for the full calendar year.

Inasmuch as very little time remains until September 30th, the end of the present fiscal year, we would appreciate your replying to the request at the very earliest opportunity so that the necessary accounting data can be accumulated without delay.

Very truly yours,

/s/ .....

DEFENDANT'S EXHIBIT 4-B

In re: [ ] Inc.

Gentlemen:

Reference is made to your letter dated September 25, 1946 requesting a ruling with respect to the procedure to be followed by the above-named corporation and its subsidiaries in making its returns for the current year.

[ ] Incorporated, and its affiliated companies filed a consolidated return for its fiscal year ended September 30, 1945. As of July 1, 1946 the parent corporation acquired complete stock ownership of the [ ] Fire and Marine Insurance Company which in accordance with the provisions of section 29.204-1 of Regulations 111 had made its returns on the calendar year basis. You propose (1) that the affiliated group file a consolidated return for its year ended September 30, 1946 including therein

the income of the [ ] Fire and Marine Insurance Company from July 1, 1946 to September 30, 1946; (2) that the [ ] Fire and Marine Insurance Company remain on the calendar year basis and file a return for the period from January 1, 1946 to June 30, 1946, the date that it became part of the affiliated group and (3) that the parent company and the subsidiaries now on the fiscal year basis make application to change to the calendar year basis effective December 31, 1946.

As indicated in your letter, section 29.204-1 of Regulations 111 require the [ ] Fire and Marine Insurance Company to make its returns on the calendar year basis. Since this company may not change its accounting period as of September 30, 1946 it may not join with its parent company in a consolidated return. The affiliated group, therefore, must be denied the right to file a consolidated return for its fiscal year ended September 30, 1946.

The parent company and its subsidiaries which are now on a fiscal year basis may make application to change their accounting periods effective December 31, 1946 if they so desire. If approved, the affiliated group could then file a consolidated return for the period from October 1, 1946 to December 31, 1946, including therein the income of the [ ] Fire and Marine Insurance Company for that period. In order to receive consideration effective December 31, 1946, the applications for change in accounting period must, in accordance with the provisions of section 29.46-1 of Regulations 111, be filed on or before November 1, 1946.

Very truly yours,

/s/ (illegible)
Deputy Commissioner.

DEFENDANT'S EXHIBIT 4-C

October 15, 1946

Commissioner of Internal Revenue
Washington, D. C.

Att: *Frank T. Eddinfield*

Gentlemen:

On behalf of our client, [ ] Inc. and its subsidiaries, we respectfully request a reconsideration of our letter of September 25, 1946. This was in connection with the proper procedure to be followed in filing a consolidated income and excess profits tax return for this consolidated group which, since July 1, 1946, has included the [ ] Fire and Marine Insurance Company.

This problem was discussed at a conference held Monday, October 14th, between several representatives of the Bureau of Internal Revenue and representatives of the taxpayer.

In the light of this discussion, we request that the procedure outlined in our letter of September 25, 1946 be approved.

Very truly yours,
/s/ .....

DEFENDANT'S EXHIBIT 5

August 21, 1951

[ ]
[ ]

Attention: Mr. [ ]

Gentlemen:

Reference is made to your letters of June 29, 1951, and to related correspondence from [ ] regarding the filing of a consolidated return for the fiscal year ending August 31 by the members of your affiliated group which includes an insurance company which is required in accordance with the applicable regulations to report its income and deductions on the calendar year basis.

You state that you have several affiliated companies, the principal ones being [ ] Company [ ] and [ ] Fire Insurance Company. Your company and all of your subsidiaries except [ ] Fire Insurance Company report their income on the basis of a fiscal year ending August 31. [ ] Fire Insurance Company is taxable under section 204 of the Internal Revenue Code, and in accordance with section 29.204-1 of Regulations 111, is required to and does report its income on the basis of a calendar year. You point out that section 24.14 of Regulations 129 requires that each member of the affiliated group report its income on the basis of the same taxable year as the common parent corporation and that, upon having elected to file a consolidated return, each subsidiary must adopt the annual accounting period of the common parent corporation not later than the close of the first consolidated taxable year ending thereafter. You further point out that there appears to be no provision covering the instant case where the insurance company is prevented by the regulations from adopting the annual accounting period of the common parent corporation.

You request to be advised whether your affiliated group may file a consolidated return for the taxable year ending August 31, 1951, if the other members of the group change their accounting period to the calendar year basis as of December 31, 1951. In letter dated July 25, 1951, from Mr. [ ] it is requested that your affiliated group

also be permitted to file a consolidated return for the fiscal year ended August 31, 1950. It is contended that your affiliated group should not be denied the privilege of filing a consolidated return for its first excess profits tax taxable year because the Excess Profits Tax Act of 1950 was not enacted until January 3, 1951, and the fiscal year members did not close their books on December 31, 1950.

As pointed out in your letter, section 24.14 of Regulations 129 states that the taxable year of an affiliated group which makes a consolidated return shall be the same as the taxable year of the common parent corporation; and upon having elected to file consolidated returns, each subsidiary corporation shall, not later than the close of the first consolidated taxable year ending thereafter, adopt an annual accounting period fiscal year or calendar year, as the case may be, in conformity with that of the common parent. Such section further provides that, if a change of accounting period is necessary in order to conform the accounting periods of the common parent and of its subsidiaries and if the requirements of section 29.46-1, Regulations 111 relating to notice of change cannot otherwise be complied with, such notice shall be furnished at or before the time of filing the consolidated return.

Section 29.204-1 of Regulations 111 requires that the returns under section 204 shall be made on the basis of a calendar year. The reason given for this provision is that section 204 of the Code provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and that such annual statement is rendered on the calendar year basis. In the light of these reasons and in view of the fact that the provision requiring the filing of calendar year returns is specific, it is held that insurance companies would not be permitted to report regularly their income on the basis of a fiscal year for the purpose of filing consolidated returns.

However, it has been the policy of the Bureau in cases of this kind to permit the filing of the first consolidated return of an affiliated group upon the basis of the fiscal year of the common parent corporation, including in such return the income of the insurance company for the period

corresponding to such fiscal year, but with the understanding that the other members of the group will immediately change their accounting period to the calendar year basis in order that the second consolidated return will be filed for the short period ending on December 31. It is apparent that, if a consolidated return is filed for the fiscal year ended August 31, 1950, it would be impossible at this time for the other members of your affiliated group to change their accounting period to the calendar year basis as of December 31, 1950.

3—[ ]

In view of the unusual circumstances here involved where the Excess Profits Tax Act of 1950 (enacted January 3, 1951) deferred the time for filing returns and paying the tax with respect to certain fiscal years ended after June 30, 1950, and where the consolidated regulations were not issued in final form until June 27, 1951, the Bureau will accept consolidated returns of your affiliated group for the fiscal years August 31, 1950 and 1951. The insurance company should include in each consolidated return its income for the period corresponding to the respective fiscal year. Furthermore, the insurance company should file an amended separate return for the period January 1, 1949, to August 31, 1949, to replace the return previously filed for the calendar year 1949. For the purpose of determining the income of the insurance company to be included in the consolidated returns and in its separate return, your attention is directed to section 24.32 of Regulations 129.

This ruling is based upon the assumption that each member of your affiliated group which reports its income on the fiscal year basis will change its method of accounting to the calendar year basis as of December 31, 1951, and that a consolidated return will be filed for the short period September 1 to December 31, 1951. In accordance with

section 24.14 of Regulations 129, the notices of change of accounting period on Form 1128 should be furnished at or before the time of filing the consolidated return. A copy of this letter should be attached to the returns filed for the years involved.

Very truly yours,
/s/ John B. Dunlap,
Commissioner.

DEFENDANT'S EXHIBIT 5-A

July 25, 1951

Commissioner of Internal Revenue
Washington, D. C.

Att: Coordinating and Advisory Division
(Mr. Earl Heft)

Re: Privilege of [ ] Company
to file a consolidated income and excess profits tax return with its subsidiaries for the taxable year ending in 1950

Dear Sir:

There was sent to you on June 29, 1951, a request for ruling to permit [ ] Company to file a consolidated income and excess profits tax return with its subsidiaries for the taxable year ending in 1951. [ ] Company now desires a further ruling to permit it to exercise such privilege for the taxable year ending in 1950.

It is understood that the members of the affiliated group are requesting an extension of time until September 15, 1951, for filing their returns for taxable years ending in 1950. The corporations who were members of the affiliated group throughout the period September 1, 1949, through August 31, 1950, were [ ] Company, [ ] Fire Insurance Company and [ ] Company.

As stated in [ ] Company's letter to you of June 29, 1951, except for [ ] Fire Insurance Company, all the members of the affiliated group report their income on the basis of a fiscal year ending on August 31. Accordingly, neither [ ] Company nor [ ] Company closed their books on December 31, 1950. For this reason, among others, it is requested that the affiliated group be permitted to file its short period consolidated income and excess profits tax return for the period beginning September 1, 1951, and ending December 31, 1951, as previously requested. Since the Excess Profits Tax Act of 1950 was not enacted until January 3, 1951, the group should not be denied the privilege of filing a consolidated return for its first excess profits tax taxable year because its fiscal year members had no opportunity to close their books on December 31, 1950.

For the foregoing reasons it is requested that a further ruling be issued to the effect that—

The affiliated group of which [ ] Company is the common parent corporation may make a consolidated income and excess profits tax return for the period beginning September 1, 1949, and ending August 31, 1950, including therein the income of every member of the affiliated group except [ ] Fire Insurance Company for the period September 1, 1949, through August 31, 1950, and including therein eight-twelfths of the income of [ ] Fire Insurance Company for the calendar year 1950, and four-twelfths of the income of [ ] Fire Insurance Company for the calendar year 1949. [ ] Fire Insurance Company shall be entitled to a pro rata refund of tax paid on its separate returns for the calendar years 1949 and 1950.

This letter is written on behalf of [ ], whose power of attorney is on file. In the event that you need additional information, please telephone [ ] or the undersigned at [ ]. A hearing is desired if for any reason the Bureau believes the foregoing facts (and those additional facts which it may call upon us to supply) do not afford sufficient basis for issuance of the desired further ruling.

Very truly yours,

[ ]

[ ]

[ ]

DEFENDANT'S EXHIBIT 5-B

July 9, 1951

Commissioner of Internal Revenue,
Washington, D. C.

Re: Privilege of [ ] Company to file a consolidated income and excess profits tax return with its subsidiaries for the taxable year ending in 1951

Dear Sir:

On July 2, 1951, [ ] Company filed an application for rulings as to the foregoing matter, at which time the undersigned formally advised a representative of the Bureau that a modification of such application might be filed within a few days for the purpose of eliminating one of the rulings therein requested.

The application filed on July 2, 1951, requested rulings on alternative sets of facts: (1) The right of the affiliated group to file a consolidated income and excess profits tax return if all the other members of the group changed their present fiscal year to the calendar year of the insurance company member of the group and (2) the right of the

affiliated group to file a consolidated income and excess profits tax return if the parent sold more than 5 per cent of the stock of the insurance company so that such company no longer would be a member of the affiliated group.

It is now desired that the Bureau of Internal Revenue issue a ruling only on the first proposal, i.e., a change in accounting period, and that a ruling not be issued on the second proposal, which relates to sale of part of the stock of the insurance company.

For the convenience of the Bureau, there is attached a copy of the application for ruling modified as if it had been filed in the form set forth above. Certain changes in language have been made in order to reflect Treasury Regulations 129, promulgated on June 29, 1951.

Very truly yours,

[ ]

[ ]

[ ]

encl.

June 29, 1951

Commissioner of Internal Revenue,
Washington, D. C.

Re: Privilege of [ ] Company to file a consolidated income and excess profits tax return with its subsidiaries for the taxable year ending in 1951

Dear Sir:

[ ] Company is a corporation with its place of business located in [ ]. It owns stock in several other corporations, its principal subsidiaries being [ ] Company of [ ] and [ ] Fire Insurance Company. [ ] Company owns 96½% of the common stock of [ ] Company of [ ] and 100% of the stock of [ ] Fire Insurance Company.

[ ] Fire Insurance Company has only one class of stock outstanding. [ ] Company of [ ] also has outstanding a class of nonvoting preferred stock which is limited and preferred as to dividends.

Except for [ ] Fire Insurance Company, [ ] Company and all of its subsidiaries report their income on the basis of a fiscal year ending on August 31. [ ] Fire Insurance Company is taxable under section 204 of the Internal Revenue Code, and by Treasury Regulations 111, sec. 29.204-1, is required to and does return its income on the basis of the calendar year.

Under section 141 of the Internal Revenue Code, the affiliated group of corporations of which [ ] Company is the common parent corporation has the privilege of making a consolidated return for the taxable year ending in 1951 in lieu of separate returns. However, Treasury Regulations 111, sec. 29.141-1(c) require that the consolidated return include every includible corporation which is a member of the affiliated group, and section 24.14 of the Consolidated Income and Excess Profits Tax Returns regulations (Treasury Regulations 129) requires each member of an affiliated group which makes a consolidated income tax return to report its income on the basis of the same taxable year as the common parent corporation. Provision is made in the last named section permitting each subsidiary to adopt the annual accounting period of the common parent corporation, upon having elected to file consolidated returns, at any time not later than the close of the first consolidated taxable year ending thereafter. However, there appears to be no corresponding provision allowing the members of an affiliated group, including the common parent corporation, to adopt the annual accounting period of a subsidiary insurance company taxable under section 204 of the Internal Revenue Code where that sub-

sidiary insurance company is prevented by the applicable Treasury Regulations from adopting the annual accounting period of the common parent corporation.

Treasury Regulations 111, sec. 29.46-1 (relating to change of accounting period) require that application for permission to change the accounting period be made direct to the Commissioner on Form 1128. However, Treasury Regulations 129, sec. 24.14(b) permit Form 1128 to be furnished as a notice of change at or before the time of filing the consolidated return where a change of accounting period is necessary in order to conform the accounting periods of the common parent and of its subsidiaries.

[ ] Company and its affiliated group seek to have made available to them the privilege of making consolidated return of their income subsequent to August 31, 1950. [ ] Fire Insurance Company, however, is required by Treasury Regulations 111, sec. 29.204-1 to include its income for the period September 1, 1950, through December 31, 1950, in its return for the calendar year 1950.

For the foregoing reasons it is requested that a ruling be issued to the effect that—

The affliated group of which [ ] Company is the common parent corporation may make a consolidated income and excess profits tax return for the period beginning September 1, 1950, and ending August 31, 1951, including therein the income of every member of the affiliated group except [ ] Fire Insurance Company for the period September 1, 1950 through August 31, 1951, and including therein eight-twelfths of the income of [ ] Fire Insurance Company for the calendar year 1951, or the actual income of the latter for the eight months January, 1951, through August, 1951. If, instead, the income of [ ] Fire Insurance Company for the entire

period September 1, 1950, through August 31, 1951, must be included in such consolidated return, [ ] shall be entitled to a pro rata refund of tax paid on its separate return for the calendar year 1950.

Thereafter, on or before March 15, 1952, the affiliated group of which [ ] Company is the common parent corporation would propose to file a short period consolidated income and excess profits tax return for the period beginning September 1, 1951, and ending December 31, 1951, including therein the income of every member of the affiliated group for this period. In the case of [ ], this consolidated return would include either its actual income for this 4-months period or four-twelfths of its income for the calendar year 1951.

Thereafter, the affiliated group of which [ ] Company is the common parent corporation would propose to make consolidated income and excess profits tax returns on the basis of the calendar year for the period beginning January 1, 1952, and subsequent calendar periods.

The foregoing to the contrary notwithstanding, no consolidated return of the affiliated group of which [ ] Company is the common parent shall include in income of the consolidated return taxable period the income of any member of the affiliated group prior to the time it became a member of the affiliated group or subsequent to the time it ceased to be a member of the affiliated group.

If [ ] is required by section 204 to file a separate calendar year return for 1951, despite the fact that its total income for such year will have been included in the two consolidated returns filed for 1951 by its affiliated group, no tax shall be deemed to be due upon such separate return of [ ].

If the affiliated group of which [ ] Company is the common parent corporation elects the foregoing procedure, [ ] Company and each member of its affiliated group other than [ ] Fire Insurance Company shall furnish the information required on Form 1128 to the Commissioner of Internal Revenue at or before the time of filing the consolidated return for the period ending August 31, 1951, including any extensions of such time.

There is attached a power of attorney designating [ ], to act for the company. It will be appreciated if you will address your reply to the company in care of [ ].

In the event that you need additional information, please telephone [ ]. A hearing is desired if for any reason the Bureau believes the foregoing facts (and those additional facts which it may call upon us to supply) do not afford sufficient basis for issuance of the desired ruling.

Very truly yours,

[ ] Company

[ ]

DEFENDANT'S EXHIBIT 6

May 22, 1953

[ ]

[ ]

In re: [ ] Company and
[ ] Insurance Company

[ ]

Reference is made to your letter dated May 4, 1953, in which you request a ruling on behalf of the above-named corporations with respect to the filing of a consolidated return by the affiliated group.

You state that [ ] Company (hereinafter referred to as "Parent") owns all of the outstanding shares of stock of [ ] Insurance Company (hereinafter referred to as "Subsidiary"), and has owned such shares since the incorporation of Subsidiary in 1945. The Parent is engaged in the business of operating a public bus transportation system in the metropolitan area of San Antonio, Texas and has a fiscal year ending May 31. The Subsidiary is an insurance company taxable under Section 204 of the Internal Revenue Code, and in accordance with Section 29.204-1 of Regulations 111, is required to and does report its income on the basis of a calendar year. The affiliated group desires to file a consolidated return at as early a date as possible, and the Parent is prepared to make an application on Form 1128 for a change of accounting period to a calendar year basis.

You request a ruling on the following:

(1) The earliest period for which a consolidated return may be filed.

(2) Period to be included for each corporation in the first consolidated return filed.

(3) Requirements as to annualization of the income of each corporation.

Section 24.14 of Regulations 129 provides that the taxable year of an affiliated group which makes a consolidated return shall be the same as the taxable year of the common parent corporation; and, upon having elected to file con-

solidated returns, each subsidiary corporation shall, not later than the close of the first consolidated taxable year ending thereafter, adopt an annual accounting period, fiscal year or calendar year as the case may be, in conformity with that of the common parent.

Section 29.204-1 of Regulations 111 requires that the returns under section 204 of the Code shall be made on the basis of a calendar year. The reason given for this provision is that section 204 of the Code states that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income, and that such annual statement is rendered on the calendar year basis. In the instant case, therefore, the Parent will be required for the purpose of filing consolidated returns to adopt a calendar year accounting period in conformity with that of the insurance company.

Upon the basis of the facts submitted, it is held that if the Parent obtains permission to change to a calendar year basis effective December 31, 1953, a consolidated return may be filed for the fiscal year ended May 31, 1953, including the income of the Subsidiary for the period June 1, 1952 to May 31, 1953, and a consolidated return may be filed for the period June 1, 1953 to December 31, 1953, including the income of the Subsidiary for such period. The Subsidiary will be required to file an amended separate return for the period January 1, 1952 to May 31, 1952, to replace the return previously filed for the calendar year 1952. For the purpose of determining the income of the Subsidiary to be included in the consolidated returns and in its separate return, your attention is directed to Section 24.32 of Regulations 129. Inasmuch as the consolidated return for the short period June 1, 1953 to December 31, 1953, is on account of a change in the accounting period, the consolidated net income and the consolidated Section 433(a) excess profits net income shall be placed on an annual basis pursuant to the provisions of Section 47(c) and 433(a)(2) of the Code.

A copy of this letter should be attached to the returns filed for the years involved.

Very truly yours,
/s/ *Norman A. Sugarman,*
Assistant Commissioner.
By /s/ *H. T. Swartz,*
Head, Technical Rulings Division.

Enclosure:
Copy of this letter.

DEFENDANT'S EXHIBIT 6-A

[ ]
[ ]

May 4, 1953

Commissioner of Internal Revenue
Washington 25, D.C.

In re: Request for Ruling,
[ ] Company and
[ ] Insurance Company

Dear Sir:

On behalf of the subject companies we wish to file herewith, in triplicate, a request for ruling re ating to the filing of consolidated income tax returns by said companies.

Also enclosed herewith are powers of attorney from each of the subject companies and fee statements duly executed by the persons named in said powers of attorney. Each of these instruments is submitted in triplicate.

It is the taxpayers' desire to file a consolidated return for the earliest period possible and therefore your prompt attention in rendering a ruling in this case will be appreciated.

[ ] and I have a conference set in your office for May 11, 1953, relative to another matter. If convenient, I would like to discuss the subject request for ruling with the party handling same some time during the afternoon of May 11th. Please advise me if a conference at such time will be agreeable.

Very truly yours,

[ ]

[ ]

[ ]

REQUEST FOR RULING
to the
Commissioner of Internal Revenue
with reference to
Proposed Filing of Consolidated Return by
[ ] COMPANY, PARENT
and
[ ] INSURANCE COMPANY, SUBSIDIARY

April 16, 1953

Commissioner of Internal Revenue, Washington 25 D.C.

Re: [ ] Company and
[ ] Insurance Company

Dear Sir:

A ruling is respectfully requested on a prospective transaction with reference to a consolidated income tax return, the essential facts of which are given below:

I. STATEMENT OF FACTS

The [ ] Company, hereinafter sometimes referred to as the Parent, a Delaware corporation with its principal place of business at [ ] owns all of the outstanding shares of the [ ] Insurance Company, hereinafter sometimes referred to as the Subsidiary, a [ ] corporation, whose principal

place of business is at [ ] and has owned such shares since the incorporation of [ ] Insurance Company in 1945. The Parent corporation has a fiscal year ending May 31, and the Subsidiary files its income tax returns on a calendar year basis.

The companies desire to file a consolidated return at as early a date as possible. Due to the fact that the Insurance Commission of the State of [ ] requires Insurance Company, the Subsidiary, to keep its books on a calendar year basis, it will be necessary for the Parent to obtain permission from the Commissioner to change its year to that of the Subsidiary. We are prepared to make application on Form 1128 for change of the Parent's fiscal year to a calendar year basis.

The Subsidiary, [ ] Insurance Company, is an insurance company other than life or mutual and is taxable under Internal Revenue Code Section 204.

The business of the Parent is the operation of the [ ]. The Insurance Company, Subsidiary, was originally formed to insure the [ ] Company, Parent, against liability resulting from injury and damage claims. The Insurance Company, Subsidiary, at first insured only its Parent. Now, however, it is writing insurance generally, but no life insurance. It is not a mutual insurance company.

II. STATEMENT OF THE LAW

Internal Revenue Code Section 141—
CONSOLIDATED RETURNS

"(a) PRIVILEGE TO FILE CONSOLIDATED RETURNS.—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consoli-

dated return for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group."

"(d) DEFINITION OF 'AFFILIATED GROUP'.—As used in this section, an 'affiliated group' means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term 'stock' does not incude nonvoting stock which is limited and preferred as to dividends."

"(e) DEFINITION OF 'INCLUDIBLE CORPORATION'.—As used in this section, the term 'includible corporation' means any corporation except—

(1) Corporations exempt from taxation under section 101.

(2) Insurance companies subject to taxation under section 201 or 207.

(3) Foreign corporations.

(4) Corporations entitled to the benefits of section 251, by reason of receiving a large percentage of their income from sources within possessions of the United States.

(5) Corporations organized under the China Trade Act, 1922.

(6) Regulated investment companies subject to tax under Supplement Q.

(7) Any corporation described in section 449, or in section 454(d)(f), and (g) (without regard to the exception in the initial clause of section 454), but not including such a corporation which has made and filed a consent, for the taxable year or any prior taxable year ending after June 30, 1950, to be treated as an includible corporation. Such consent shall be made and filed at such time and in such manner as may be prescribed by the Secretary.

(8) Regulated public utilities described in section 448(d) which compute their excess profits credit under section 448 but not including any such regulated public utility which has made and filed a consent, applica-

ble to the taxable year, to compute its excess profits credit without regard to section 448. The consent shall be made and filed at such time and in such manner as may be prescribed by the Secretary. The consent shall be applicable to the taxable year for which filed and to each consecutive subsequent taxable year for which a consolidated return is filed."

In our case, it is believed that a consolidated return of the two companies is permissible due to the fact that the two companies form an affiliated group in accordance with the definition in Section 141(d) of the Internal Revenue Code. The Parent owns all of the stock of the Subsidiary. The corporations are both includible corporations in accordance with the definition in Section 141(e) of the Internal Revenue Code.

III. REQUEST FOR RULING

On behalf of the corporations mentioned above it is respectfully requested, in the absence of informative regulations, that the Commissioner rule on the following:

(1) What is the earliest period for which a consolidated return may be filed?

(2) What months' operations must be included for each corporation in the first consolidated return filed?

(3) What annulization of the income will be required in the case of each corporation?

It is of considerable importance to the taxpayers that a consolidated return be filed for as early period as possible. Accordingly your prompt attention in rendering a ruling will be indeed appreciated.

Powers of attorney in duplicate and statements relative to fees are enclosed for the following taxpayers:

[ ]
[ ]

In accordance with the terms of the powers of attorney submitted herewith, it is requested that correspondence on this matter be addressed to the following:

[ ]
[ ]

Respectfully submitted,
[ ]
[ ]

DEFENDANT'S EXHIBIT 7

Jan. 18, 1956.

[ ]
[ ]

Gentlemen:

This is in reply to your letter dated December 28, 1955, in which you request a ruling with respect to the filing of consolidated returns upon the acquisition by your corporation of an insurance company subject to tax under section 831(a) of the Internal Revenue Code of 1954.

Your company is a common parent of an affiliated group which filed a consolidated return for the period January 1, 1954, to September 30, 1954, having obtained permission to change from the calendar year basis. An extension of time has been obtained to March 15, 1956, for the filing of consolidated return for the fiscal year ended September 30, 1955.

On January 1, 1955, you acquired the [ ] Insurance Company, (hereinafter referred to as [ ]), a fire and casualty company taxable under the provisions of section 831(a) of the 1954 Code. [ ] files its returns on the basis of a calendar year as required by

section 39.204-1(a) of Regulations 118 (T. D. 6091, C. B. 1954-2, 47). On February 1, 1955, [ ] acquired 80% of the capital stock of [ ] Manufacturing Company, Inc., a newly-organized includible corporation.

You make several inquiries which are dependent upon whether the calendar year basis must be adopted for the purpose of filing consolidated returns.

Section 1.1502-14(a) of the Income Tax Regulations, provides as follows:

> "(a) The taxable year of an affiliated group which makes a consolidated return shall be the same as the taxable year of the common parent corporation; and, upon having elected to file a consolidated return, each subsidiary corporation shall, not later than the close of the first consolidated taxable year ending thereafter, adopt an annual accounting period, fiscal year or calendar year as the case may be, in conformity with that of the common parent."

2—[ ]

In view of the specific provisions of the regulations with respect to the filing of returns on a calendar year basis by insurance companies taxable under section 204(a)(1) of the 1939 Code and section 831(a) of the 1954 Code, it is concluded that * * * would not be permitted to report its income on the basis of a fiscal year ending September 30, for the purpose of filing consolidated returns.

Inasmuch as the affiliated group of which your company is the common parent includes every corporation which was a member of the group within the meaning of section 1504(a) of the Code, it would not be proper to file one consolidated return on a calendar year basis for * * * and its subsidiary, and another consolidated return on a fiscal year basis for * * * Corporation and its remaining subsidiaries.

If permission is granted for you to change your accounting period to a calendar year basis effective December 31, 1955, a consolidated return may be filed for the fiscal year ended September 30, 1955, including the income of [ ] for the nine months ended September 30, 1955. A consolidated return may be filed for the period October 1, 1955, to December 31, 1955, including the income of [ ] for such period. For the purpose of determining the income of [ ] to be included in the consolidated return, your attention is invited to section 1.1502-32 of the Income Tax Regulations.

The application for change in accounting period (Form 1128) submitted with your letter, will be made the subject of a separate communication.

Very truly yours,

/s/ *H. T. Swartz,*
Director, Tax Rulings
Division.

DEFENDANT'S EXHIBIT 7-A

December 28, 1955

[ ]
[ ]

Received Technical Reference Branch Dec. 29, 1955
Commissioner of Internal Revenue
Washington 25, D.C.

REQUEST FOR RULING

Dear Sir:

[ ] Corporation, [ ] filed a consolidated Federal income tax return (Form 1120) for itself and certain subsidiaries covering the period from January 1, 1954, to September 30, 1954. Prior to this period, the corpora-

tion's taxable year had been the calendar year. Permission from your office was obtained for the change in taxable year.

A consolidated return for [ ] Corporation and its subsidiaries covering the full fiscal year ended September 30, 1955, is due to be filed on or before December 15, 1955. Form 7004 has been filed extending the filing date to March 15, 1955.

During the period from September 30, 1954, to September 30, 1955, [ ] Corporation acquired 80% or more of the capital stock of certain other includible corporations. Among these was [ ] Insurance Company, [ ], a fire and casualty company, taxable under the provisions of 1954 Code Section 831(a), which was acquired on January 1, 1955, and was still owned at September 30, 1955. [ ] Insurance Company filed returns on a calendar year basis prior to January 1, 1955. On February 1, 1955, [ ] Insurance Company acquired 80% of the capital stock of Lone Star Manufacturing Company, Inc., an includible corporation for consolidated return purposes. [ ] is a new corporation, having had no operations prior to February 1, 1955.

We are concerned with the apparent conflict in regulations applicable to the filing of consolidated returns and those applicable to the filing of a return for an insurance company. In that connection, we include herewith as Exhibit A what we believe to be the applicable code and regulations sections. Also included as Exhibit B is a copy of a ruling by your office in a situation similar to ours.

The apparent conflict in our case lies between the provisions of 1939 Code, Sec. 204(a)(1), Regulations 111, Sec. 29.204-1 (regulations have not been released on the corresponding 1954 code section), which requires the filing of an insurance company's return on a calendar year basis,

and 1954 code regulations applicable to consolidated returns, which require a subsidiary to adopt the fiscal year of its parent.

Under the assumption that [ ] Insurance Company would be included in the consolidated return for the period from January 1, 1955, date of its acquisition, to September 30, 1955, we have had that company prepare on an official annual statement form all required schedules and exhibits relating to its operations for that period.

In connection with the foregoing, we respectfully request your ruling with respect to the following questions:

1. Will a consolidated return of [ ] Corporation and subsidiaries for the year ended September 30, 1955, including [ ] Insurance Company operations for the nine months ended September 30, 1955, be acceptable to your office?
2. If the answer to question one is in the affirmative, will subsequent consolidated returns, including the insurance company, on the basis of a fiscal year ending September 30 be acceptable?
3. If the answer to question one is in the negative, will it be acceptable to file one consolidated return for [ ] Insurance Company and its subsidiary, [ ] Manufacturing Company, Inc., for the calendar year 1955 and another consolidated return for [ ] Corporation and its remaining subsidiaries for the year ended September 30, 1955?
4. As an alternative to any of the foregoing questions, may a consolidated return for [ ] Corporation and subsidiaries, including [ ] Insurance Company, be filed for the year ended September 30, 1955, under the condition that the affiliated group thereafter change its taxable year to the calendar year?

Form 1128, application for change in accounting period, is enclosed herewith with the request that it be considered only in case your ruling requires that the affiliated group change its taxable year to the calendar year.

Since a return for this affiliated group is shortly to become due, it will be appreciated if you can expedite your ruling on the questions presented herewith.

Respectfully yours,

(SEAL)

[ ] Corporation
[ ]
[ ]

PLAINTIFF'S EXHIBIT A

Interoffice memorandum dated January 11, 1957 from John Potts Barnes, Chief Counsel, Internal Revenue Service, to Justin F. Winkle, Assistant Commissioner (Technical), Internal Revenue Service.

JUSTIN F. WINKLE
Assistant Commissioner (Technical)
Attention: *Bulletin Branch*

Reference is made to your memorandum (T:S:BRA JSD) dated June 11, 1956, by which you forwarded for the concurrence of this office a proposed revenue ruling based upon a communication (T:R:C-DD) dated January 18, 1956, in the case of the above-named taxpayer.

The proposed revenue ruling deals with an affiliated group of corporations which has previously filed consolidated income tax returns on a fiscal year basis. The common parent then acquires all of the stock of a fire and casualty insurance company, an includible corporation under section 1504(b) of the 1954 Code, which insurance company is required, however, by section 843 of the Code to report its income on a calendar year basis.

The consolidated return regulations (section 1.1502-14 (a)) require that the includible subsidiary corporations adopt the annual accounting period of the parent. The proposed revenue ruling attempts to reconcile the conflict between section 843 of the Code and section 1.1502-14(a) of the consolidated return regulations.

It is the opinion of this office that the proper solution to the problem presented requires an amendment to the consolidated return regulations. The L. & R. Division of this office has, with the concurrence of the Technical Planning Division, undertaken a project to amend the consolidated return regulations to provide a solution to the problem presented by the instant case. In view of this, the proposed revenue ruling is returned without the approval of this office.

The administrative file is returned herewith.

/s/ John Potts Barnes
John Potts Barnes
Chief Counsel
Internal Revenue Service

Enclosure:
Adm. file

PLAINTIFF'S EXHIBIT B

(Filed July 16, 1963)

Interoffice memorandum dated October 30, 1946 from Deputy Commissioner, Bureau of Internal Revenue, to Chief Counsel, Bureau of Internal Revenue.

Memorandum for the Chief Counsel
Bureau of Internal Revenue

In re: [ ]
[ ]

The attached ruling letter in which it is proposed to modify Bureau letter dated October 10, 1946, with respect to the procedure to be followed by The [ ] Inc., and its subsidiaries in making its returns for the current year is transmitted for your consideration and recommendation as to the action indicated therein.

Attention is called to the fact that the situation in this case is somewhat different from that upon which C. U. R. 1661 was based in that the fiscal year of the parent company falling within the calendar year 1946 ends on a date subsequent to its acquisition of the stock of the insurance company. This circumstance raises the question as to whether the parent company by reason of such acquisition and notwithstanding the fact that it will comply with the provisions of the regulations (as applied in C. U. R. 1661) with respect to adopting an accounting period for 1946 to conform to the accounting period of the insurance company, will be precluded from filing a consolidated return for its fiscal year ended September 30, 1946.

It appears that under a strict interpretation of the regulations a denial of the right to file a consolidated return for the above-mentioned year would be justified but in view of the circumstances in the case and the apparent desire of the companies involved to fullfil the requirements of the regulations with respect to filing consolidated returns, it is believed that the granting of such right would not jeopardize the Government's interest and that from an administrative standpoint the proposed ruling is sound.

PLAINTIFF'S EXHIBIT C

(Filed July 16, 1963)

Interoffice memorandum dated February 1, 1944 from J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, to Deputy Commissioner Cann, Bureau of Internal Revenue.

DEPUTY COMMISSIONER CANN
Income Tax Unit.

Reference is made to the attached letter (*not legible*) addressed to the Internal Revenue Agent in Charge, Chicago, Illinois, in response to his inquiry whether an insurance company other than a life or mutual insurance company subject to tax under section 204 may change its taxable year from the calendar year to the fiscal year of the parent in order to be included in an affiliated group for the purposes of filing consolidated excess profits tax returns.

The information submitted indicates that [ ] Insurance Company (which is stated to be a 100 per cent subsidiary of [ ] Corporation) is a stock casualty insurance company taxable under section 204 of the Internal Revenue Code; that it filed income tax returns on a calendar year basis for 1939 and 1940; and that, in order to join with its parent company (which files its returns on the basis of a fiscal year ending November 30) in the filing of a consolidated return for the year 1941, it secured permission from the Commissioner under date of December 11, 1941 (IT:P:T:1-ASH) to change its accounting period from a calendar year to a fiscal year ending November 30, effective for the period ended November 30, 1941.

In the letter prepared in this case it is now proposed to reverse the prior action of the Bureau and hold that an insurance company subject to tax under section 204 of the Internal Revenue Code and the corresponding sections of

prior revenue acts may not change from the calendar year basis to the fiscal year of the parent corporation for the purpose of filing consolidated returns.

2—[.] Insurance Company.

The regulations of the Department have uniformly construed section 204 of the Internal Revenue Code and the corresponding sections of prior revenue acts to require insurance companies taxable under those sections to file returns on a calendar year basis. It follows as a general rule that an insurance company subject to tax under section 204 may not be included in an affiliated group unless the group as a whole is prepared to file consolidated returns on a calendar year basis. This office accordingly concurs in the conclusion reached in the proposed letter in the instant case.

The companies involved in the instant case have, pursuant to authority granted by the Commissioner, filed returns for prior years on the basis of a fiscal year ending November 30, and a change of all the corporations from a fiscal year to a calendar year basis may not be effected under the provisions of section 29.46(1) of Regulations 111 prior to December 1944. It is therefore suggested that the revocation of the authority granted under date of December 11, 1941, be applied without retroactive effect and that the tax liability of the affiliated group for years prior to 1945 be determined on the basis of returns filed in accordance with the authority previously granted. In the event the group does not desire to file consolidated returns on a calendar year basis for 1945 and subsequent years, it is suggested that it be permitted to file individual returns inasmuch as the election to file returns on the basis of a

fiscal year ending November 30 was made pursuant to authority contained in a ruling of the Bureau which it is now proposed to revoke.

The administrative file is returned herewith.

/s/ *J. P. Wenchel*
J. P. Wenchel
Chief Counsel
Bureau of Internal Revenue

Attached:
Administrative file.

DEFENDANT'S BRIEF IN OPPOSITION TO PLAINTIFF'S MOTION TO PRODUCE

QUESTION PRESENTED

Whether the taxpayer's motion seeks the production of privileged matter?

STATEMENT

On January 4, 1962, plaintiff filed a motion for production of documents in this case. The motion sought the production of:

1. A memorandum from Deputy Commissioner of the Income Tax Unit to the Chief Counsel dated October 30, 1946, which pertained to the ruling letter identified as Exhibit 4 to the deposition of Assistant Commissioner Swartz. This document is discussed in the deposition at pp. 118-119, 121-123.

2. All of the Chief Counsel's files pertaining to the rulings identified as Exhibits 1 through 7 to the deposition of Mr. Swartz.

3. The General Counsel's memorandum dated January 11, 1957, pertaining to the ruling letter identified

as Exhibit 7 to the deposition of Mr. Swartz. This document is discussed in the deposition at pp. 151-152, 153-158.

4. The technical advice memorandum from the Director, Tax Rulings Divisions, to the District Director, Chicago, Illinois, with respect to this case.

The Court heard argument on this motion on January 5, 1962. At the argument on the motion, the Government opposed the motion on a number of grounds, first, on the basis of relevance, second, on the basis of attorney-client privilege, third, on the basis that the document sought under paragraph 4 of the motion represented work-product within the doctrine of *Hickman* v. *Taylor,* 329 U.S. 495, and finally, on the basis of executive privilege. Due to the short notice, the Government requested some further time to submit a brief on the question of executive privilege and an affidavit of the Commissioner of Internal Revenue formally asserting executive privilege with respect to the documents sought. The Court granted the Government further time for the filing of such a brief and affidavit and set the motion for further argument on the afternoon of January 11, 1962.

At the hearing on the motion the taxpayer orally amended paragraph 2 of the motion to cover only General Counsel's Memoranda or other memoranda from the Chief Counsel to the Tax Rulings Division or the Assistant Commissioner (Technical) or the Commissioner. An inspection of the files has revealed that there is only one document falling within paragraph 2 of the motion as amended; namely, a General Counsel's Memorandum dated February 11, 1944, which pertains to the ruling letter identified as Exhibit 1 to the deposition of Mr. Swartz.

Attached to this brief is the Commissioner's affidavit formally claiming executive privilege against the production of these four documents. Since the Court so requested, this brief will deal only with the Government's claim of executive privilege. The Government, however, continues to assert the other grounds relied on in resisting the taxpayer's motion.

ARGUMENT

TAXPAYER'S MOTION SHOULD BE DENIED SINCE THE DOCUMENTS SOUGHT TO BE PRODUCED ARE PRIVILEGED MATERIALS

The fundamental basis for claiming privilege in regard to intra-agency memoranda is the same one which supports the existence of Government privilege in the area of state secrets (*United States* v. *Reynolds,* 345 U.S. 1), informers (*Scher* v. *United States,* 305 U.S. 251), and Grand Jury Minutes (*United States* v. *Pittsburgh Plate Glass Co.,* 360 U.S. 395; *United States* v. *Procter & Gamble Co.,* 356 U.S. 677), as well as the privilege surrounding a lawyer's work-product (*Hickman* v. *Taylor, supra*). This basis is public policy. More definitively, there is a public policy in favor of the executive's legitmate interest in having internal agency processes operate with the freedom that comes only with a right to privacy. The Government privilege asserted in this case is a privilege for the privacy of internal and intra-agency memoranda, containing legal analysis, opinions, and recommendations, in short, the mental processes and work product of the executive.

For example, in a leading case in this area, *Kaiser Aluminum & Chemical Corp.* v. *United States,* 157 F. Supp. 939, 946 (C. Cls.), Mr. Justice Reed, sitting by designation, denied a motion to produce an advisory opinion on inter-office policy, stating:

> There is a public policy involved in this claim of privilege for this advisory opinion—the policy of open, frank discussion between subordinate and chief concerning administrative action.

Also, in *Continental Distilling Corp.* v. *Humphrey,* 17 F.R.D. 237, 241 (D.C. D.C.), the court, in holding that departmental interoffice memoranda and the mental operations of the Alcohol & Tobacco Tax Division of the Internal Revenue Service were not discoverable, stated:

> Plaintiff is not entitled to discovery of the mental operations by which defendants arrived at their opinions or made their judgments.

Or, to state it a different way, as the court said in *United States* v. *Procter & Gamble Co.,* 25 F.R.D. 485, 489 (D.C. N.J.):

> [T]he Government, operating as it does through a hierarchy of agents, must have the benefit of their full, free advices, and since those advices may well cover angles of a case which would hamper the Government's action if publicized, normally these advices should not be turned over to those with interests hostile to that of the Government.

See also, *Cenname* v. *Bingler,* decided January 30, 1961, D.C. W.D. Pa. (61-1 U.S.T.C., par. 15,346), and the very recent decision of Judge McNamee in *E. W. Bliss Co.* v. *United States,* Civil No. 35729, D.C. N.D. Ohio (as yet not reported; a copy of Judge McNamee's opinion is attached for the Court's convenience).

When the underlying reason for the privilege is applied to the documents sought to be produced here, it is clear, the Government submits, that their production should not be compelled. The memorandum from the Deputy Commissioner to Chief Counsel dated October 30, 1946, the two General Counsel's memoranda, and the Technical Advice Memorandum represent the opinions and analysis of one office of the Internal Revenue Service put down on paper to advise another. The Service, and for that matter, any Government agency, is necessarily dependent on the free interchange of ideas, advice, analysis and opinion between its divisions and employees in order to advance its business. These materials and memoranda are prepared without the anticipation that they will be disclosed; the writers feel free to discuss both sides of an issue because they believe that what they put down will not go outside the Service. If their memoranda were to be made public, or their disclosure could be compelled by taxpayers and the opinions in the memoranda used as admissions, inevitably the writers would feel constrained to limit their discussions in the memoranda to a pro-government analysis. In other words, Service employees could not analyze the situation and freely give their superiors or other divisions a fair and unbiased written view of the merits of the issue, discussing all sides of the issue. Consequently, public policy favors the privacy of intra-agency memoranda of this type.

This would appear particularly true with respect to the Technical Advice memoranda sent by the Tax Rulings Division to District Directors in response to requests for advice. The National Office of the Service, by necessity, must put its views and advice on the issues in written communications to the Directors. The memoranda may discuss all sides of an issue, and then come up with a conclusion on balance; it may set forth the opinions of other branches or divisions of the Service. It represents a legal interpretation of the issues in question, an analysis of the law, and a discussion as to what position the District Director should take. If documents such as these are to

be turned over to the taxpayers whose problems are discussed in the memoranda, so that taxpayer can in effect pick the Service's legal brain, it is obvious that the National Office's technical advice memoranda will have to be revised to express only the final decision.

The taxpayer cited *Boeing Airplane Co.* v. *Coggleshall*, 280 F. 2d 654 (C.A. D.C.) at the hearing on January 5, 1962. This case is not in point, and in fact, supports the Government's claim of privilege here. There, the court upheld, over a claim of privilege, a *subpoena duces tecum* for investigative or third-party reports submitted to the Renegotiation Board, after the Board called as witnesses some of the writers of these reports, but then went on to say (280 F. 2d at 660):

> To the extent that the documents deal with recommendations as to policies which should be pursued by the Board, or recommendations as to decisions which should be reached by it, the claim of privilege is well-founded.

The court apparently attempted to make a broad differentiation between documents of a "routine factual nature" as against "'advice' by persons in a 'common cause'," (280 F. 2d at 661)—in other words, "fact finding" as compared with "decision making" documents (280 F. 2d 662)—and upheld the claim of privilege as to the second class of documents.

The documents in question in this case clearly fall within the "decision-making" type. They are legal memoranda and discussions which, the Government submits, are privileged. Their production should not be compelled.

CONCLUSION

The Government urges that the Commissioner's claim of executive privilege be upheld, and the taxpayer's motion to produce be denied.

Respectfully submitted,

LOUIS F. OBERDORFER,
Assistant Attorney General.
EDWARD S. SMITH,
JEROME FINK,
R. MICHAEL DUNCAN,
Attorneys,
Department of Justice,
Washington 25, D.C.

JAMES P. O'BTIEN,
United States Attorney.

January, 1962.

AFFIDAVIT

Washington,)
) ss.
District of Columbia)

Mortimer Caplin, being duly sworn, deposes and says under oath:

1. I am the duly designated Commissioner of Internal Revenue, having official custody and control of the files and records of the Internal Revenue Service pursuant to such designation.

2. I have inspected Plaintiff's Motion for Production of Documents filed on January 4, 1962, in the above-entitled case, and have been advised that plaintiff orally amended, at the hearing on January 5, 1962, paragraph 2 of this motion to cover only General Counsel's memoranda

or other memoranda from the General Counsel to the Deputy Commissioner, Income Tax Unit, or the Assistant Commissioner (Technical) pertaining to the seven ruling letters which appear as Defendant's Exhibits 1 through 7 to the deposition of Assistant Commissioner Swartz.

3. I have examined the documents covered by plaintiff's motion, and production of these official intra-agency memoranda would be injurious to the public interest. The basis for my determination is that the matters demanded by the taxpayer constitute internal work-product, mental processes and opinions of representatives of the Internal Revenue Service, and, in addition, with respect to the documents sought by paragraph 4 of plaintiff's motion, a legal opinion by representatives of the Internal Revenue Service as to the merits of this very case.

4. I, therefore, assert a formal claim of executive privilege against the production demanded by the taxpayer.

Dated this 9th day of January, 1962.

/s/ *Mortimer Caplin*
Mortimer Caplin
Commissioner of Internal Revenue

Subscribed and sworn to before me
this 9th day of January, 1962.
/s/ *Ruth L. Apple*
Notary Public
My commission expires June 14, 1966.

IN THE

DISTRICT COURT OF THE UNITED STATES
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CIVIL ACTION NO. 35729

E. W. BLISS COMPANY,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

RE: MOTION TO PRODUCE

McNAMEE, J.:

It is a recognized general principle that in actions involving the administration of Federal law to which the Government is a party, production of Government documents should be permitted unless "the Court is satisfied that it would be against public policy to do so." 4 Moore, *Federal Practice*, 2nd Ed., § 26.25(6), p. 1176. However, in all but exceptional cases it is considered against the public interest to compel the Government to produce interagency advisory opinions. *Kaiser Aluminum & Chemical Corp.* v. *U.S.*, 157 F. Supp. 939, 946 (Ct. Cl. 1958); *U. S.* v. *Procter & Gamble Co.*, 25 F.R.D. 485, 489, (D.C. N.Y. 1960); *Continental Distilling Co.* v. *Humphrey*, 17 F.R.D. 237; *Cenname* v. *Bingler*, Civil No. 17060 (W.D. Pa. 1961). The reasons underlying the privilege are stated fairly in *U. S.* v. *Procter & Gamble, supra*:

> "(t)he Government, operating as it does through a hierarchy of agents, must have the benefit of their full, free advices, and since those advices might well

cover angles of a case which would hamper the Government's action if publicized, normally these advices should not be turned over to those interests hostile to that of the Government."

The taxpayer has not sustained the burden of showing a waiver of the privilege. In a supplemental affidavit filed November 13, 1961 plaintiff cited *Geometric Stamping Co.* v. *Commissioner of Internal Revenue,* 26 Tax Ct. 301 (1956) and *Klein Chocolate Co.* v. *Commissioner of Internal Revenue,* 36 Tax Ct. 12 (1961) as support for its position. As pointed out by the Government, however, an issue in the cited cases was whether the approval of the Commissioner to a change in the method of valuing inventory was shown by the acts of his agent. No such issue arises here nor does the question of consistency of method followed by the taxpayer appear to be pertinent. If consistency becomes an issue, plaintiff has available witnesses who can testify that the taxpayer followed a consistent method. There is no necessity for recourse to the transmittal letters to meet that issue. The issue here is whether the taxpayer has valued its inventory in accord with the applicable regulations. It is not apparent that the production of the transmittal letters is essential to the proper presentation of plaintiff's case. Good cause for the production of such documents has not been shown, and in the circumstances of this case the Government's claim of privilege is well taken.

The motion to produce is overruled.

/s/ *Charles J. McNamee*
United States District
Judge

December 13, 1961.

BRIEF FOR THE DEFENDANT IN SUPPORT OF ITS PROOF OF ADMINISTRATIVE PRACTICE

QUESTIONS PRESENTED

1. Is the testimony of Assistant Commissioner Swartz together with the exhibits offered evidence of a practice existing in the Internal Revenue Service?

2. Assuming that Swartz' testimony is evidence of a practice, what was the effect of the practice?

STATEMENT

On September 11, 1961, the taxpayer filed a Motion for Summary Judgment and on September 26, 1961, the Government filed a Cross Motion for Summary Judgment, attaching an affidavit by Assistant Commissioner Swartz with respect to an administrative practice of the Internal Revenue Service. On October 13, 1961, taxpayer filed a motion for continuance of the summary judgment proceedings for the purpose of taking the deposition of Assistant Commissioner Swartz. The Court held several hearings on this motion. At a hearing on October 23, 1961, taxpayer's counsel presented the Court with an oral motion to strike the affidavit on the ground that the matter set out therein was irrelevant and inadmissible. Extensive briefs were filed by both parties on the relevance of the practice and a hearing on the motion to strike the affidavit was held on November 20, 1961. A further hearing was held on December 11, 1961, at which time the Court ruled that the affidavit should be stricken as insufficient and inadmissible to establish the fact of the practice (Tr. Dec. 11, 1961, p. 7). The Court went on to point out that the Government was free to use other evidence to establish the practice and that the Court's ruling to strike the affidavit was on the ground that it was inadmissible to prove this fact. The Court then directed the Government to proceed with the evidence relevant to the existence of the practice (Tr. Dec. 11, 1961, p. 8). The Court did not rule on the relevance of this practice.

On December 19, 1961, the Government deposed Harold T. Swartz, Assistant Commissioner of Internal Revenue. At a hearing on January 11, 1962, the Government offered the deposition of Mr. Swartz. The taxpayer objected to the admissibility of the deposition in evidence on several grounds. The Court accepted the offer of the deposition subject to taxpayer's objections. Taxpayer then offered three documents (Pltfs. Exs. A, B and C) and stated that it might wish to call further witnesses if the Court should sustain its objection The Court then requested briefs as to what the deposition established and as to the merits of the taxpayer's objections to the deposition's admissibility.

ARGUMENT

I.

THE EXISTENCE OF AN ADMINISTRATIVE PRACTICE IS RELEVANT TO A DECISION OF THE ISSUES IN THIS CASE.

It is appropriate here to summarize again for the Court the Government's purpose in introducing evidence with respect to an unpublished, administrative practice of the Internal Revenue Service in connection with this case. The sole issue in this case is whether the taxpayer qualifies for the so-called "growth" excess profits credit. Under Section 435(e) of the Korean War Excess Profits Tax Law, the taxpayer urges that it is entitled to the benefits of the growth credit and the Government maintains that it is not entitled to the benefits of the growth credit but must use the usual base period average income method. The point of dispute between the Government and the taxpayer is whether it meets the twenty million dollar total asset test contained in Section 435(e)(1)(A)(i). The question is under this total assets test, whether Allstate assets should be combined with those of its parent Sears, Roebuck, the Government maintaining that they should be so combined

and the taxpayer maintaining that they should not be. If Allstate's assets are combined with Sears, the total assets would be vastly in excess of twenty million dollars and Allstate would not qualify for the growth credit. If Allstate's assets are not to be combined with Sears, Allstate meets the test since its assets are less than twenty million dollars. The statutory language of the "total assets" test requires the combination of the taxpayer's assets with those "of all corporations with which the taxpayer has the privilege under Section 141 of filing a consolidated return" for its first taxable year ending after June 30, 1950. It should be noted that the statute in its very nature sets up a hypothetical situation. The statute is not in terms of combining the taxpayer's assets with those of corporations with which it did file consolidated returns but rather those with which it could file a consolidated return. As the Government views it then, the situation must be viewed in terms of whether the taxpayer could have filed a consolidated return with Sears, if it had wanted to.[1]

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[1] The Government wishes to draw the Court's attention to the fact that its primary position in this case is that the total assets test, as enacted by Congress, contemplated the combination of taxpayer's assets with all the assets of members of an affiliated group; thus, in the Government's view, if the taxpayer qualifies as a member of an affiliated group, its assets must be combined with those of the other members, for purposes of the total assets test and qualification for the growth credit. However, the taxpayer does not agree with this construction of the statute. It is in connection with taxpayer's theory of the construction of this statute that the administrative practice becomes relevant. Since the Court requested a brief only on this question, and not on the over-all merits of the case, the Government will not deal with its member of an affiliated group argument in this brief, or with certain other arguments which the Government

(Footnote continued)

Thus, it was the basic purpose of the Government in putting in evidence the existence of an administrative practice to show that *if* Allstate had wanted to file a consolidated return with its parent Sears, it would have been permitted to do so. In other words, the Government has shown that Allstate *could have filed* a consolidated return with Sears, because the Commissioner would have allowed it to do so in accordance with the well-established practice. The deposition of Mr. Swartz shows that, if Allstate had wanted to, it could have filed a consolidated return with its parent Sears. The mechanics of accomplishing this simply require that both Allstate and Sears file short period returns to bring them together on a calendar year accounting basis. From that point on, a consolidated return is filed on the annual basis. Government exhibit 5 spells out in some detail exactly how this was done in a comparable situation for this precise period.

As the Government views it, the deposition in this case shows that Allstate could have filed a consolidated return with Sears in accordance with a practice of the Internal Revenue Service. Accordingly, since Allstate could have filed a consolidated return with Sears for the first taxable year after June 30, 1950, its assets should be combined

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(Footnote continued)

can make on the over-all merits of the case. This brief is confined solely to evidence as to what would have happened if taxpayer had wanted to file a consolidated return with its parent in the hypothetical situation posed by the statute, and will attempt to point out that under the practice of the Internal Revenue Service, it is reasonably clear that taxpayer could have filed a consolidated return if it had wanted to. Thus in the Government's view, even under taxpayer's theory of the statutory language, it is not entitled to prevail. For a fuller discussion of these questions, see the Brief for the Defendant in Opposition to Plaintiff's Motion to Strike Affidavit of Assistant Commissioner, pp. 5-9.

with Sears for purposes of the total assets test and it should not be entitled to use the growth method of computing its excess profits credit.

II.

THE GOVERNMENT HAS USED PROPER METHODS TO SHOW THE EXISTENCE OF AN ADMINISTRATIVE PRACTICE WITHIN THE INTERNAL REVENUE SERVICE

A. *The existence of an administrative practice within the Internal Revenue Service is a question of fact, to be proven by methods similar to those used in the proof of any fact.*

It is submitted that the existence of an administrative practice within the Internal Revenue Service should be proven by the same methods which are used to prove any other fact—that is, by introducing the testimony of a person acquainted with the facts, together with other evidence proving that the fact exists. In the present proceeding, the Government has introduced the testimony of Assistant Commissioner of Internal Revenue Harold T. Swartz, an individual who is probably more fully acquainted than is any other person in the nation with the facts concerning the administrative practices of the Revenue Service in issuing rulings. The Government has also introduced documentary evidence which together with Swartz' testimony clearly establishes the existence of the administrative practice in question. This documentary evidence, coupled with Commissioner Swartz' testimony, indicates that an unvarying administrative practice has existed in the Internal Revenue Service since 1944. Under this practice, rulings have repeatedly been given to affiliated corporate groups, one of which is an insurance company, granting the group permission to file consolidated tax returns.

Admittedly, there is little precedent with respect to methods of proving unpublished administrative practice within the Internal Revenue Service. But this hardly prevents a showing that such a practice does in fact exist. In approaching this problem, the methods used are strikingly similar to those used to prove the law of a foreign jurisdiction in an American court. In America, foreign law is regarded as a fact, and the courts require litigants to plead and prove the content of that law in a manner similar to the proof of any other evidentiary fact. See Schlesinger, Comparative Law, 32-140, Brooklyn, Foundation Press (1950).

The reasons for analogizing proof of administrative practice to proof of foreign law become clear when one examines the rationale behind the rule that foreign law is to be proven in the same way as any other matter of fact. The basic reason for this rule has been summarized as follows (Nussbaum, *The Problem of Proving Foreign Law*, 50 Yale Law Journal, 1018):

> Although courts are expected to know their own law, they cannot be expected to know the law of other countries. Hence litigating parties must prove the applicable foreign law to the court.

There is one other reason for proving foreign law as a matter of fact:—the judicial materials needed to prove foreign law are often not available to a domestic court. The importance of this second factor is demonstrated by the history of the statutes which today generally permit state courts to take judicial notice of the law of sister states within the United States. Prior to the passage of these statutes, it was necessary to prove the "foreign" law of a sister state as a matter of fact. However, the practice of judicially noticing the law of a sister state did not develop until the growth of law libraries and legal publishing services made the judicial materials of each state readily available throughout the country. See Nussbaum, *The Problem of Proving Foreign Law*, 50 Yale L. J. 1018, 1020-1023.

The reasons which have made it necessary to prove foreign law as a matter of fact are the same reasons which should impel the Court in the present case to allow the Government to prove administrative practice within the Internal Revenue Service as a matter of fact. Just as the Court cannot be expected to be familiar with the law of other countries, so the Court cannot be expected to know about all administrative practices within a federal executive department.

Because the problem of ascertaining this administrative practice within the Internal Revenue Service is similar to the problem of ascertaining the law of a foreign jurisdiction, it is submitted that the methods of solving these two problems should also be similar:—that administrative practice should be proven as a matter of fact just as foreign law is proven as a matter of fact.

At least one American court has so held. *State ex rel. Bartlett* v. *Davis*, 69 N.H. 350, 41 Atl. 267. In this case a witness was permitted to testify as to the contents of the files of the Internal Revenue Department office in Portsmouth, New Hampshire, and the significance of certain notations on records in those files. After referring to the rules of the Internal Revenue Department, the Supreme Court of New Hampshire held (69 N.H. 350):

> No good reason appears why proof of them [the rules] may not be made in like manner as the laws of foreign states are proved.

B. *Assistant Commissioner Swartz was a proper person to offer testimony as to the existence of an administrative practice within the Internal Revenue Service.*

Assuming that the analogy urged above is accepted, the question arises whether correct methods of proving this administrative practice within the Internal Revenue Service have been used in the present case, in light of the evidentiary doctrines developed in cases in which the parties have introduced proof as to the law of a foreign jurisdiction. The basic American doctrine on this subject is summarized in *Ennis* v. *Smith,* 55 U.S. (14 How.) 399, 425:

> The written foreign law may be proved, by a copy of the law properly authenticated. The unwritten must be [proved] by the parol testimony of experts.

Later Supreme Court cases indicate that the proper way of proving foreign law as a fact is to introduce a copy of any statute involved, or the deposition of one skilled in the law of the foreign jurisdiction, or both. *Nashua Savings Bank* v. *Anglo-American Land, Mortgage, and Agency Co.,* 189 U.S. 221; *Slater* v. *Mexican National R.R. Co.,* 194 U.S. 120. See also Sommerich and Busch, *The Expert Witness and the Proof* of Foreign Law, 38 Corn. L. Q. 125, 128-30 (1953).

In the *Nashua Savings Bank* case, the court received into evidence copies of what purported to be British corporation statutes to which was attached the deposition of the manager of a British corporation who was also an attorney with thirty years experience. In the *Slater* case, a translation of a Mexican statute was introduced together with the deposition of a Mexican lawyer as to what the statute meant. In *Slater,* the lower court had rejected the deposition under the best evidence rule, but the Supreme Court held that this was error. In light of these cases, the introduction of Commissioner Swartz' deposition in the present case appears proper.

The cases just cited may give the impression that the party who testifies as to the foreign law must himself be an attorney. This is not so. The basic case, repeatedly cited for the proposition that a skilled layman may testify as to foreign law, is the *Sussex Peerage Case,* 11 Cl. & F. 85 (House of Lords, 1844). The *Sussex* case held that a Catholic bishop should be permitted to testify as to the marriage law of the Roman Catholic Church. The holding in the *Sussex* case was discussed with approval in *Ennis* v. *Smith,* 55 U.S. (14 How.) 399,427. The most recent United States cases applying the doctrine of the *Sussex* case are *Murphy* v. *Bankers Commercial Corporation,* 111 F. Supp. 608 (D.C. S.D. N.Y. 1953), and *Eustathiou* v. *United States,* 154 F. Supp. 515 (D.C. E.D. Va. 1957).

Questions have also been raised as to whether the witness who testifies as to the law of a foreign jurisdiction must be a member of the bar of that jurisdiction, or a resident of the country whose law is involved The *Sussex, Murphy,* and *Eustathiou* cases, cited in the previous paragraph, indicate that the witness need not be a member of the bar, need not have practiced law in the foreign jurisdiction, and need not be a resident of the foreign country involved, provided he is otherwise skilled. Hence, by analogy, there should be no need to show that Commissioner Swartz is an attorney, or has practiced tax law, or been in the Internal Revenue Service—except as a means of demonstrating his skill as an interpreter of Revenue's administrative practices. However, Commissioner Swartz' credibility is certainly strengthened by the Government's demonstration of his long experience with the Revenue Service.

C. *The Files of the Internal Revenue Service Were Thoroughly Searched for Materials Indicating Service Practice.*

The filing system within the Internal Revenue Service will be discussed in detail in Section III, A, of this brief. At that time it will be shown that the file and index system is designed in such a way as to prevent the issuance of rulings which contradict one another in their application to similar facts. Commissioner Swartz' testimony indicates that this system was applied with great thoroughness in the search for rulings pertaining to the issue in the present case. The search ". . . exhausted all ways and means of locating all correspondence with respect to this particular issue." (Dep. 104.) Not only were the general and precedent files of the Rulings Division searched, but the personal files of specialists within the Rulings Division were also examined as a means of double checking the search of the official files. (Dep. 44.) As a consequence, Commissioner Swartz was able to testify that "If there were any rulings that we don't have that were issued in this area, they would have been issued along the same lines." (Dep. 51.)

D. *Commissioner Swartz was fully Qualified to Testify as to Practice Within the Internal Revenue Service.*

The Government's witness, Mr. Harold T. Swartz, Assistant Commissioner of Internal Revenue (Technical) ~~has~~ extensive experience in the Internal Revenue Service. He has been with the Revenue Service over twenty-six years (Dep. 10) and has risen from Internal Revenue agent to his present position. (Dep. 10.) In 1951, he was appointed Assistant Deputy Commissioner of the Income Tax Unit; in 1952, he became Director of the Tax Rulings Division; and in 1958, he assumed his present position as Assistant

Commissioner (Technical). (Dep. 12-13.) As Assistant Commissioner (Technical), he has charge of the Rulings Division. (Dep. 13.) Consequently, since 1951, Mr. Swartz has been directly associated with the process of issuing rulings in response to taxpayer requests. (Dep. 14.)

Commissioner Swartz' testimony indicates that he possesses very extensive familiarity with both the process of issuing rulings, and with the individuals who have worked within the Rulings Division of the Internal Revenue Service. See, for example, his testimony at page 14 of his deposition and at pages 16-17 where his familiarity with ruling procedure is particularly apparent. In addition, during the course of his testimony, he had frequent occasion to identify the initials of individuals who had written or approved rulings issued by the Internal Revenue Service. (Dep. 49-50, 91, 96, 129-130.) This indicates his familiarity with the individuals who wrote or approved the seven rulings introduced by the Government in the present case, and his knowledge of the procedures followed in issuing those rulings.

THE DEPOSITION OF MR. SWARTZ AND THE ATTACHED EXHIBITS ESTABLISH WITH REASONABLE CERTAINTY WHAT WOULD HAVE HAPPENED IF ALLSTATE HAD DECIDED TO FILE A CONSOLIDATED RETURN WITH ITS PARENT, SEARS, ROEBUCK & COMPANY, FOR THE FIRST EXCESS PROFITS TAX YEAR

A. *The Testimony of Commissioner Swartz*

Commissioner Swartz' testimony in his deposition touches on three subjects: The ruling process within the Internal Revenue Service, the ruling index system within the Internal Revenue Service, and the practice of the Internal Revenue Service in connection with the filing of consolidated returns by an affiliated group where one of the affiliates is an insurance company.

In connection with the ruling process in the Internal Revenue Service, Commissioner Swartz stated that rulings are generally issued in response to a request from a taxpayer who wishes to know the tax consequences of a specified transaction. (Dep. 15-16.) He used taxpayer's inquiries as to the tax consequences of a change of accounting periods as a means of showing how the ruling process works. (Dep. 17.) He pointed out that the main function of a ruling is to advise the taxpayer as to the tax result which he can expect if he consummates a transaction, such as a change in accounting period, in the way outlined in his request for a ruling. (Dep. 17.) Commissioner Swartz stated that between 30,000 and 40,000 requests for rulings are received by the Revenue Service each year. (Dep. 16.)

The bulk of Commissioner Swartz' testimony concerned the methods of indexing and filing rulings so as to facilitate retrieval of the information which they contain. This testimony as to the Service's methods of information retrieval is important because it demonstrates that a system exists within the Revenue Service which assures that all requests for rulings based on similar facts are answered in the same way.

The ruling files within the Internal Revenue Service are of three types: general files, precedent files, and personal work files. No ruling files exist in any other office. (Dep. 98.) Copies of all issued rulings are placed in either the general files or the precedent files. (Dep. 15, 35.) The general files contain rulings which are not considered to have precedential value. (Dep. 22.) The rulings in the general files are indexed in broad categories. (Dep. 22, 35.) The broad category for rulings of the kind involved in the present suit is "Consolidated Returns." (Dep. 107.) The Service's precedent files will be discussed in greater detail below; their purpose, as the name implies, is to index

those rulings which are considered to have precedential value, as contrasted with those rulings which are placed in the general file. (Dep. 70.) Finally, each individual specialist keeps copies of rulings which he has prepared. (Dep. 35.) These personal files are passed on to the specialist's successor when the specialist retires or goes to some other branch of the Internal Revenue Service. (Dep. 105.) The rulings contained in a specialist's personal files, of course, duplicate the contents of the general and precedent files, since the general and precedent files are complete, official files, while the personal files contain only material of particular interest to the individual specialist. (Dep. 44-45, 35-36.) Service practice is ascertained by a study of the general and the precedent files. (Dep. 194.) An examination of a specialist's personal files is made only as a means of double checking the results of a search of the official files. (Dep. 35, 44.)

The practice of keeping a precedent file came into existence at some time prior to 1943, probably long before 1943. (Dep. 86.) The precedent files are currently maintained within the Technical Organization headed by Commissioner Swartz. (Dep. 13, 15, 69.) These files contain rulings which, in the opinion of classification personnel, establish a precedent to be followed in issuing later rulings. (Dep. 22, 70.) Materials are often selected for inclusion in the precedent files because they have been reviewed by and received the approval of the office of the Commissioner of Internal Revenue and the Chief Counsel's office. (Dep. 49, 187.) The purpose of the precedent file is to separate those few rulings which establish precedents from the many which do not. (Dep. 70.) Before a new ruling is issued, individuals working in the Rulings Division check the precedent file to ascertain the Internal Revenue Ser-

vice's position on the issues involved in the request on which they are working. (Dep. 33, 48.) Materials in the precedent file are indexed both by name of case and by precedent, unlike the materials in the general files which are indexed only under broad categories. (Dep. 35.)

The indexing system of the precedent files is designed to insure that new rulings based on facts similar to those involved in prior rulings receive identical answers. (Dep. 48.) The indexing system makes it highly unlikely that any ruling could be issued on the subject involved in the present suit which took a position contrary to that shown in defendant's exhibits 1 through 7. (Dep. 48.) *The reason for this is that if a ruling in the precedent file is superseded, it is removed from the precedent file and placed in the general file.* (Dep. 48, 185-186.) As a result of this procedure, Commissioner Swartz was able to testify unequivocally that no one in the Income Tax Unit could have issued a ruling contrary to the rulings contained in the precedent file. (Dep. 50-51.) This testimony indicates that the precedent file system insures that similar positions are taken by the Revenue Service on similar facts.

Commissioner Swartz testified at considerable length about the use of Confidential Unpublished Rulings (CUR's) within the Internal Revenue Service. (Dep. 57-9, 99-103.) This testimony is important because defendant's exhibit 2, the ruling letter of May 26, 1945, was circulated to the field as a Confidential Unpublished Ruling. (Dep. 93.) These Confidential Unpublished Rulings are documents which are sent to the field to provide guidance for Internal Revenue agents. (Dep. 102-103.) These rulings are not cited by name, because the Internal Revenue Service has a long-established policy of keeping secret the names of taxpayers who request rulings. (Dep. 100.) These Confidential Unpublished Rulings are important to the

revenue agents in the field because they constitute a useful research tool. (Dep. 103, 187.) CUR's are indexed in Internal Revenue Service field offices by use of a card index. (Dep. 189.) This index is available to reviewers, revenue agents, and conferees. (Dep. 190.)

Although the bulk of Commissioner Swartz' testimony concerns the filing and index system just discussed, the Commissioner also testified as to what that system had produced as to Revenue Service practice in dealing with affiliated corporate taxpayers, one of which is an insurance company, when the affiliated group wishes to file a consolidated return. The pertinent Revenue practice originated as a result of an apparent conflict in the regulations. (Dep. 157, 159, 176-178.) This apparent conflict arose because the Code required insurance companies to file their returns on a calendar year basis, while the regulations permitted the filing of consolidated returns by parents and subsidiaries. In situations in which a parent on a fiscal year basis owned or acquired an insurance company subsidiary, the provisions of the regulations appeared to make it impossible to file a consolidated tax return.

Commissioner Swartz testified that the Revenue Service might have adopted a "hard-nosed position" which would have denied anyone the privilege of filing a consolidated return in this situation. (Dep. 178.) However, he pointed out that the Commissioner had, instead, found an "administrative way" of allowing parent corporations with insurance company subsidiaries to file consolidated returns. (Dep. 178, 46-47, 74-75, 126.) Commissioner Swartz also described how this practice had been implemented by means of income tax returns filed for "short accounting periods." (Dep. 127, 148-149, 183-184.) The purpose of these short accounting period returns was to put both parent and subsidiary on a calendar year accounting basis.

B. *An Analysis of the Rulings Contained in Defendant's Exhibits 1 through 7.*

The Government's position is that the rulings contained in Exhibits 1 through 7 speak for themselves. However, it may be useful to refer to some of Commissioner Swartz' statements as to what these rulings hold, and to briefly summarize each of these rulings for ready reference.

Commissioner Swartz' testimony pointed out that the subject matter of these rulings is the filing of consolidated returns by an affiliated group where one of the affiliates is an insurance company. (Dep. 34, 37, 39, 107.) He also stated specifically the holding of the ruling contained in Defendant's Exhibit 1 (Dep. 74-75) and Defendant's Exhibit 2 (Dep. 87-88, 92.) The substance of the Commissioner's statements is that the rulings hold that Internal Revenue Service practice permits the filing of consolidated returns by a corporate parent if it takes action to change its accounting period to correspond with that of its insurance company subsidiary.

A brief discussion of each of these ruling letters follows:

(1) Defendant's Exhibit 1 is a ruling dated February 14, 1944. It is discussed at pages 20 and 21 of Commissioner Swartz' deposition and again at pages 74 and 75. It is contained in the Internal Revenue Service's precedent file. This ruling deals with a situation in which an insurance company had been allowed to change to a fiscal year basis in 1941 for the purpose of filing consolidated returns with its parent. In this ruling the Internal Revenue Service states that the insurance company should not have been allowed to file on a fiscal year basis and that it must return to a calendar year basis. Permission to continue to file consolidated returns was granted, provided the entire

group changed to a calendar year basis. The Service agreed to accept consolidated fiscal year returns and consolidated short period returns while this changeover was being made.

(2) Defendant's Exhibit 2 is a ruling dated May 26, 1945. It is contained in the Revenue Service's precedent file and is discussed in Commissioner Swartz' deposition at pages 22-24, 87-88, and 92. In this instance, a parent corporation which filed on a fiscal year basis expected to acquire an insurance company subsidiary in July 1945. It requested information as to how they could file consolidated returns for the last six months of 1945. The Internal Revenue Service ruled that, if the parent company shifted to a calendar year accounting basis and submitted a short period return, a consolidated return could be filed with the insurance company subsidiary for 1945. This ruling became Confidential Unpublished Ruling 1661.

(3) Defendant's Exhibit 3 is a ruling dated September 12, 1945. It is contained in the Internal Revenue Service's general file, and it is discussed at pages 24-25 of Commissioner Swartz' deposition. In this instance, a corporation which owned an insurance company subsidiary requested permission to file a consolidated return on a fiscal year basis. The Service ruled that it could not allow a permanent shift to a fiscal year basis by an insurance company.

(4) Defendant's Exhibit 4 is a ruling letter dated February 5, 1947. It is contained in the precedent file and is discussed at pages 25-28 and pages 119-120 of Commissioner Swartz' deposition. In this instance, a corporation which acquired ownership of an insurance company in July of 1946 wished to file consolidated returns for the last six months of 1946 and all subsequent periods. The

Internal Revenue Service ruled that such returns could be filed if the corporation and its insurance subsidiary changed to a calendar year basis, effective December 31, 1946. The ruling also outlines the "short period return procedure" to be followed in making this shift of accounting period and allows submission of consolidated fiscal year returns during the changeover period.

(5) Defendant's Exhibit 5 is a ruling dated August 21, 1951. It is contained in the Internal Revenue Service's general file and is discussed at pages 28-30 of Commissioner Swartz' deposition. In this instance, the parent corporation wished to file a consolidated return for excess profits tax purposes with its insurance company subsidiary for the last four months of 1949 and all subsequent periods. The Internal Revenue Service ruled that such returns could be filed if the insurance company amended its returns for prior periods and filed appropriate short period returns, and if the parent corporation and its other subsidiaries changed to a calendar year basis effective December 31, 1951. Submission of consolidated fiscal year returns for prior periods was allowed.

It is important to note that this ruling letter states that "*. . . it has been the policy of the Bureau in cases of this kind* to permit the filing of the first consolidated return upon the basis of the fiscal year of the common parent. . . ." (Ruling letter, p. 2.) [Emphasis added.] It is submitted that this quotation is determinative of the existence of an established practice within the Internal Revenue Service.

(6) Defendant's Exhibit 6 is a ruling dated May 22, 1953. It is contained in the Internal Revenue Service's general files and is discussed at pages 30 and 31 of Commissioner Swartz' deposition. Here, a parent company which had acquired an insurance subsidiary in 1945 wished

to file a consolidated return with its subsidiary at the earliest possible time. The Revenue Service ruled that a consolidated return could be filed for all periods subsequent to May 31, 1952, if the parent corporation changed to a calendar year accounting basis, and if appropriate "short period returns" were filed. Permission to file a consolidated fiscal year return for the year ending May 31, 1953, was granted.

(7) Defendant's Exhibit 7 is a ruling dated January 18, 1956. It is contained in the Revenue Service's precedent file, and is discussed at pages 31-34 of Commissioner Swartz' deposition. In this instance, the corporate parent acquired an insurance company subsidiary on January 1, 1955. Information was requested as to how to file a consolidated return for the year 1955. The Internal Revenue Service ruled that a consolidated return could be filed if the parent shifted to a calendar year basis and filed appropriate short period returns. Permission to file a consolidated fiscal year return for the year ending September 30, 1955, was granted.

These seven rulings, taken together, indicate that it has been the practice of the Revenue Service since 1944 to permit the filing of consolidated returns by parent corporations which own insurance company subsidiaries, and, further, that in instances when this has necessitated a shift of accounting periods the Service has consistently followed the practice of allowing the very first consolidated return to be made on the fiscal year of the parent, provided that subsequent action was taken to shift both the parent and its subsidiaries to a calendar year basis.

C. *Rulings Issued After December 31, 1950, Are Relevant To the Decision of this Case.*

Evidence as to a course of conduct may be shown by reference to events which occur after a transaction is completed rather than solely by transactions or occurrences

prior to or during the period in question. As the Court pointed out at the last hearing, it is quite possible, for example, to prove membership of a person in a particular party or group by showing conduct prior to the critical date and conduct subsequent to that date even though there may be a complete hiatus during the critical period. (Tr. Jan. 11, 1962, pp. 39-40.)

Nor is such a method of proof unknown in the tax field. Mertens in his treatise on Federal Taxation makes the point clear in connection with determining the nature of real estate transactions.

> The facts consequently are open to examination not only for the particular tax years in issue, but also for years prior and subsequent to the years in issue. (3B Mertens, Law of Federal Income Taxation (Rev.), Sec. 22.138 at p. 625.)

The holding in *Ehrman* v. *Commissioner*, 120 F. 2d 607, 610 (C.A. 9) is to the same effect.

The doctrine just discussed indicates that the testimony of Commissioner Swartz as to the practice of the Internal Revenue Service during periods subsequent to December 31, 1950, is relevant to a decision of the issues in this case. Certainly, if the Revenue Service is shown to have followed a particular practice both before *and* after a given date, it is inherently likely that it followed that practice on the date in question. This is especially true when evidence, such as defendant's exhibit 5, indicates practice during the precise period under examination in the present case. However, defendant's exhibits 6 and 7, which relate to later periods, are also relevant in light of the principles discussed above because they show that no change took place to disturb the unvarying administrative practice within the Internal Revenue Service instituted in 1944 and consistently applied from that time forward and that it was accepted *as a practice* by the Service.

SUMMARY

The Government has shown by use of documentary evidence and expert testimony that an unpublished administrative practice existed within the Internal Revenue Service from 1944 to 1956 under which the Allstate Insurance Company could have filed consolidated excess profits tax returns with its parent, Sears, Roebuck and Company, had Allstate wished to do so. The methods used to prove the existence of this practice have been shown to be proper in light of the techniques used to prove similar questions of fact in other cases.

The proof of administrative practice offered by the Government establishes with reasonable certainty that, had Allstate Insurance chosen to request permission to file a consolidated excess profits tax return with Sears, Roebuck and Company at any time from 1944 onward, permission to do so would have been granted by the Internal Revenue Service. Because Allstate *could have* filed such a return, it is ineligible for the special "growth credit" provided by Section 435(e)(1)(A)(i) of the Korean War Excess Profits Tax Law as an aid to the expansion of small corporate enterprises.

Respectfully submitted,

Louis F. Oberdorfer,
Assistant Attorney General.
Edward S. Smith,
David A. Wilson, Jr.,
Thomas F. Field,
Attorneys,
Department of Justice,
Washington 25, D. C.

James P. O'Brien,
United States Attorney.

February, 1962.

AFFIDAVIT OF MAILING

State of Illinois, County of Cook—ss.

Bruno W. Tabis, Being first duly sworn, on oath deposes and says that he is employed in the Office of the United States Attorney for the Northern District of Illinois; that on the 5th day of February, 1962, he placed a copy of:

BRIEF FOR THE DEFENDANT IN SUPPORT OF ITS PROOF OF ADMINISTRATIVE PRACTICE 60 C 322
(Allstate Insurance Co. v. United States)
in a Government franked envelope addressed to:

Charles W. Davis, Esq.
Hopkins, Sutter, Owen, Mulroy & Wentz
1 North LaSalle Street
Chicago, Illinois

and that he placed said envelope in the United States mail chute located in the United States Court House, Chicago, Illinois, on said date at the hour of about 5:00 P. M.

/s/ Bruno W. Tabis

Subscribed and Sworn to before me,
this 5th day of February, 1961.
/s/ Steve Balyar
Notary Public

SUPPLEMENTAL BRIEF FOR THE DEFENDANT IN SUPPORT OF ITS PROOF OF ADMINISTRATIVE PRACTICE

INTRODUCTION

Because the present proceedings have become so complicated, it may be useful at this time to recapitulate for the Court the basic issue involved in this case, so that the crux of this dispute does not become lost in a welter of briefs.

In enacting the Korean War Excess Tax Act of 1950, c. 1199, 64 Stat. 1137, Congress provided a special credit for small companies which had experienced unusual growth in the period after World War II. Sec. 435(e). However, if a company had total assets of more than $20,000,000, it was ineligible for this special growth credit. Sec. 435(e)(1)(A)(i). In order to prevent large affiliated corporate groups with small subsidiaries from improperly taking advantage of the "growth credit", Congress required that any affiliated group of companies which could file a consolidated income tax return was not to be eligible for the "growth credit" if the total assets of the affiliated group exceeded $20,000,000.

There can be no question whatsoever that if Allstate had been an ordinary business corporation rather than an insurance company, it could have filed a consolidated return with its giant parent, Sears Roebuck & Company. Allstate would, under those circumstances, be ineligible for the "growth credit" which it now requests. Hence, Allstate's claim that it is eligible for the "growth credit" is founded entirely upon the fact that it is an insurance company which was required to file calendar year tax returns. Because this calendar year filing requirement exists, Allstate claims that it could not have filed a consolidated return with its gigantic corporate parent, Sears,

and that it is, therefore, eligible for the "growth credit". In effect, Allstate is arguing that Congress must have intended the test of eligibility for the "growth credit" to apply generally to affiliated groups of companies but not to Allstate-Sears because of Allstate's insurance company status. There is no justification in the statute or its legislative history for the creation of a technical exception of this sort.

In any event, the Government now seeks to show that, under an existing practice within the Internal Revenue Service, even Allstate could have filed a consolidated return with its parent, Sears. This being so, Allstate, like all other subsidiaries of giant parent corporations, must pay its Korean excess profits taxes at the normal rates.

IMMEDIATE ISSUE INVOLVED

Throughout its brief, the taxpayer insists that the "only question" involved in the present exchange of briefs "is whether Sears and Allstate had the privilege of filing a consolidated return for the taxable year ended December 31, 1950". See, for example, Br. 16, 19, 56. Since this is a serious misconstruction of the issues here involved, a short discussion of this matter seems appropriate.

The Government seeks to show that, as a result of an established practice in the Internal Revenue Service, Allstate-Sears could have requested permission to file a consolidated income tax return at any time after February 1944, and that, if requested, such permission would have been granted provided that appropriate short period returns were filed. Consolidated calendar year returns could have been filed thereafter.

The Government also seeks to show that, as a result of the same administrative practice in the Service, Allstate-Sears could have requested permission to file a consolidated return immediately after the passage of the Korean War Excess Profits Tax Act, *had they wished to do so, and*

that permission would have been granted to file a consolidated fiscal year return for Sears' fiscal year ending January 31, 1951, provided that Sears-Allstate then filed a consolidated short period return for the remainder of 1951 and that Allstate filed a separate short period return for January 1950. The Government has attached a chart appendix to this brief; Chart VIII diagrams the procedure just described.

In short, the question presented in this exchange of briefs concerns the existence of an administrative practice in the Internal Revenue Service from 1944 onward, not exclusively whether Allstate-Sears had a "privilege" on December 31, 1950. As Government counsel pointed out in argument (Tr. January 11, 1962, pp. 45, 55-9), there appears to be a difference between the parties as to whether the term "privilege" appearing in Sec. 435(e)(1)(A)(i) of the Korean War Excess Profits Tax Act means "absolute right" or "opportunity". This is obviously a statutory construction problem. In its present brief, the taxpayer has repeatedly attempted to introduce a discussion of this statutory construction problem. A discussion of this question is, of course, important to a determination of this case. However, the present briefs were to be directed solely to the question of the Government's proof of administrative practice within the Internal Revenue Service. (Tr. January 11, 1962, pp. 67-71.) To inject at this time questions which have been reserved for argument at a later date can only be interpreted as an attempt to confuse the issues and influence the thinking of the Court before the proper opportunity for legal argument appears.

Repeated attempts by the taxpayer to argue that he did not know about the practice in question (Pltf. Br. pp. 17-18, 20, 23, 71-72, 74) are also irrelevant to a decision

of the issue now before this Court, because the Government has introduced proof of the Service's administrative practice only to show what Allstate *could have done if they had wanted to,* not what Allstate-Sears wanted to do or was required to do. To make the same point another way, because Sec. 435(e)(1)(A)(i) of the Korean War Excess Profits Tax Act is couched in hypothetical terms, taxpayer's reliance is not an issue in this case and cannot be.

For its part, the Government will confine its remarks in this brief solely to the question of the Government's proof of administrative practice and how this proof fits in with the provisions of Sec. 435(e)(1)(A)(i) of the Korean War Excess Profits Tax Act.

I

COMMISSIONER SWARTZ'S DEPOSITION SHOWS THAT ALLSTATE-SEARS COULD HAVE FILED A CONSOLIDATED RETURN AT ANY TIME SUBSEQUENT TO 1944

A brief statement may be helpful at this point to outline what the Government believes Assistant Commissioner Swartz' deposition shows as to how Allstate-Sears could have filed a consolidated return.

It is the Government's view that the deposition of Assistant Commissioner Swartz and the attached exhibits clearly indicate that, if Allstate-Sears had requested permission to file a consolidated return at any time subsequent to the year 1944, they would have been granted permission to do so under the procedures outlined in the deposition and in those exhibits. The mechanics of the changeover would have been relatively simple. *Allstate could have filed a consolidated fiscal year return with Sears* and both companies would then have filed a consolidated short period return to place them on a calendar year basis. Both companies could have continued to file consolidated calendar year returns thereafter. This procedure as applied to the year 1951 is outlined in Chart VIII, attached to this brief.[1]

Allstate-Sears, however, seeks to advance a disappearing privilege theory. While it is incontrovertible that the taxpayer had the opportunity to file a consolidated return at any time subsequent to 1944, it argues in its brief that this privilege mysteriously disappeared in the year 1950. (Pltf. Br. 38, 40, 63.) It bases this "disappearing privilege argument" on the fact that Allstate-Sears took no action in 1950 to file a consolidated return. But this fact does not mean that the opportunity to file a consolidated return evaporated in that year. Assistant Commissioner Swartz' deposition and the attached exhibits show that the opportunity to file such a return had existed since 1944, *even though it was never utilized by Allstate-Sears, and even though it was unlikely to try to use that opportunity.* Again, the Government wishes to emphasize that the point

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[1] In its brief (pp. 20, 38, 44, 55) the taxpayer apparently concedes that, had Allstate-Sears applied to file a consolidated return at any time prior to November 1, 1950, permission "might have been granted". And, "if so, a consolidated return could have been filed for the short taxable period from February 1, 1950, through December 31, 1950". (Pltf. Br. 55.) (For a schematic presentation of this concession, see the *alternative* method in Chart VIII.) In the Government's view, this concession should decide the issue before the Court at the present time because this concession means that Allstate-Sears could have filed a consolidated return for the first taxable year ending after June 30, 1950.

The taxpayer may contend that it had no reason to file such a consolidated return, but this fact is of absolutely no importance here, since the question before the Court is not whether the taxpayer wished to file such a return or thought of filing such a return, but rather whether the taxpayer *could have* filed such a return had it chosen to do so. The taxpayer's concession describes one way in which a consolidated return could have been filed.

is *not* what the taxpayer wanted to do, but the hypothetical question what it *could have done* if it had wanted to.

But let us assume, *arguendo,* in spite of the Commissioner's practice since 1944, and in spite of the taxpayer's concession discussed in footnote 1, below, that Allstate-Sears was unable to begin to file consolidated calendar year returns at any time between 1944 and January 3, 1951, the date of enactment of the Korean War Excess Profits Tax Act. Even if we make this assumption, the fact still remains that Allstate-Sears could have begun to file consolidated returns as of the close of January 1951. The truth of this statement will become more apparent in connection with the discussion of Defendant's Exhibits 1, 4, 5, 6, and 7, below. However, a short examination of the mechanics of the possible filing procedure is in order at this time. Sears' first taxable year ending after June 30, 1950, came to an end on January 31, 1951. The proven practice shows that Allstate-Sears could have filed a consolidated return by including Allstate's income along with Sears' in a consolidated return for the fiscal year ending January 31, 1951. Allstate would then have filed a separate amended return for the month of January 1950 and both Sears and Allstate would have filed a consolidated short period return for the last eleven months of 1951. Thereafter, they would have filed consolidated calendar year returns. See Chart VIII attached to this brief for a diagram of this procedure. Allstate *need not have given advance notice of its intention to file a consolidated return with Sears on Sears' taxable year* since such notice is not required when a subsidiary conforms its fiscal year to that of its parent. Sec. 24.14(b), Treasury Regulations 129 (1939 Code). However, the advance notice provisions would, of course, apply to the change of Allstate-Sears to a calendar year basis as of December 31, *1951.*

II

TAXPAYER'S ALLEGED LACK OF KNOWLEDGE OF THE COMMISSIONER'S ADMINISTRATIVE PRACTICE IS NOT RELEVANT TO A DECISION OF THE ISSUES BEFORE THIS COURT

Throughout its brief, the taxpayer repeatedly speaks as if there were some reliance interest of Allstate-Sears which is jeopardized by the Government's effort to prove the existence of an unpublished administrative practice within the Internal Revenue Service. For example, the taxpayer argues that publication of the administrative practice under consideration at the present time should have been required (Pltf. Br. 17, 18, 20, 74.) But publication or the lack of it would be pertinent only if Allstate-Sears' *knowledge* of this practice were in some way pertinent to a decision of the issues in this case. But the question in the view of the Government is *not* whether Sears or Allstate knew about or acted in reliance on the administrative practice under examination; *the pertinent question is whether such a practice existed* and whether and when a consolidated return could have been filed. Hence, the taxpayer's repeated attempts to introduce the question of publication into these briefs is misleading to the Court.

The absurdity of the taxpayer's complaints regarding the matter of publication is pointed up with particular clarity when one asks how the actions of Allstate-Sears would have differed in the years 1950 and 1951 had this administrative practice appeared in published form. It is most doubtful indeed that either Sears or Allstate would have acted differently had it known of the existence of the practice, because neither firm was likely to want to incur the additional 2% tax which must be paid when a consolidated return is filed. Sec. 141(c), 1939 Code.[2] Hence,

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[2]As amended by Sec. 159(a), Revenue Act of 1942, c. 619, 56 Stat. 798.

there is no way in which the lack of publication of the administrative practice here in question can be said to have influenced Allstate-Sears to its detriment. This argument is solely an attempt to obscure the issues before the Court.

In a similar vein, the taxpayer contends that what Allstate-Sears might or might not have done subsequent to the time that the Korean War Excess Profits Tax became law on January 3, 1951, should affect the Court's decision as to whether there existed an administrative practice within the Internal Revenue Service under which a consolidated return could have been filed. But to argue in this way is simply to insert confusions into this case. Allstate-Sears did not have any greater reason to file a consolidated income tax return after the passage of the Korean War Excess Profits Tax Act than it did before that Act became law. The corporate group had the same opportunity to file such a return before and after the passage of the Act. The knowledge that the Act had passed did not affect the taxpayer's actions on the filing or non-filing of consolidated returns, nor did it change the fact that ever since 1944 the taxpayer could have filed such returns had it chosen to do so. Hence, the taxpayer merely confuses the issue when it argues that, as of the date of the passage of the Korean Excess Profits Tax Act, it was too late to file a consolidated return for 1950. This is an erroneous argument in the first place, since Allstate-Sears could have filed a consolidated fiscal year return on January 31, 1951, but, even if the argument were not erroneous, it is still needless since the fact that Allstate-Sears took no steps to file a consolidated return does not change the fact that *an administrative practice existed under which they could have filed a consolidated return had they chosen to do so.*

III
REPLY TO TAXPAYER'S ARGUMENT I

A. Taxpayer's Argument I A

In the first paragraph of argument heading I A, the taxpayer states that Assistant Commissioner Swartz never had occasion to define the term "administrative practice". The taxpayer therefore concludes that there is no precedent showing how to prove administrative practice within the Internal Revenue Service. This argument is certainly a non-sequitur. Even a glance at a treatise such as Davis's Administrative Law or at the Administrative Procedure Act (5 U.S.C. 1952 ed., Sec. 1001), c. 324, 60 Stat. 137, will indicate that terminology in administrative law is by no means uniform. The fact that Assistant Commissioner Swartz had not had occasion to define a given administrative law term means nothing, as Assistant Commissioner Swartz pointed out immediately after being asked whether he had ever had occasion to define adminstrative practice. He said (Dep. 182-183):

> This is what the Internal Revenue Service has been doing. It has been their procedure, their policy, their position. Practice is as good a word, as far as I know. The practice has been to issue rulings along this line and there has not been any change in that practice.

The taxpayer further confuses the issue by referring to the statement in the Government's brief (p. 7) that "there is little precedent with respect to methods of proving unpublished administrative practice within the Internal Revenue Service". Any reasonable reading of the Government's brief would surely have indicated that the Government there referred to *legal* precedents, not to the state of Assistant Commissioner Swartz's understanding of the terminology of administrative law.

In any event, the taxpayer has not dealt with the arguments developed by the Government with respect to methods of proving unpublished administrative practice

within the Internal Revenue Service, except to say that it finds them "astounding". (Br. p. 22.) But it is not enough simply to cast aspersions on the Government's method of proving Service policy. One might ask how, if the Government's method of proof is insufficient, one does prove an unpublished policy.

It would certainly be wrong to say that such unpublished policies can never be proved in a court of law, because eminent authorities on federal taxation have pointed out that unpublished Service practice may often be crucial to the resolution of a tax problem. For example, Mr. Erwin Griswold, now Dean of the Harvard Law School, has stated unequivocally that "Treasury construction and practice *** may even appear, and quite plainly, in certain types of cases, *where no public ruling has been issued at all*". Griswold, A Summary of the Regulations Problem, 54 Harv. L. Rev. 398, 417 (1941). (Emphasis added.) The Dean then goes on to say (Op. Ct. p. 418):

> Where the practice clearly appears, and where it has in fact been long continued, it should be given effect in the interests of sound tax administration. There should be no rule limiting the effect of administrative construction in all cases to formal regulations and Treasury decisions.

After mentioning that he has not forgotten the statement in the Cumulative Bulletins that the Treasury does not consider itself bound even by published rulings, the Dean succinctly summarizes his views on the importance of Service practice (54 Harv. L. Rev. 398, 418, n. 60):

> Bureau [Service] practice is Bureau practice, and when it clearly appears and has been long continued, it should be given effect regardless of the form in which it appears.

B. *Taxpayer's Argument I B*

Taxpayer's argument I B indicates that it either has not understood or wishes to confuse the essential legal

issues involved in the present exchange of briefs. After a short review of the procedure by which the Revenue Service issues rulings, the taxpayer states (Br. 24) that "It is significant that only the taxpayer who actually requests and receives the ruling may rely on it * * *." But the taxpayer completely fails to show why this is "significant". The Government submits that, as outlined earlier, the question of reliance is completely irrelevant to a decision of the issue before the Court at the present time, *viz.*, whether the Government has shown the existence of an administrative practice within the Internal Revenue Service under which Allstate-Sears could have filed a consolidated tax return. It is not important to determine whether or not Allstate-Sears knew of the Service's practice or whether or not it relied on the practice. The only question presently before the Court is whether such a practice did in fact exist. It confuses the issues needlessly to enter, as the taxpayer does, into a long discussion as to whether taxpayers can rely on rulings issued to other parties.

C. *Taxpayer's Argument I C*

At page 26 of its brief, the taxpayer, in the course of a discussion of the files in the Tax Rulings Division of the Internal Revenue Service, seeks to give the impression that the Commissioner sometimes changes his mind on a ruling even though the facts, law, or Regulations have not changed. But the taxpayer fails to point out that no such changes have occurred since 1944 in connection with the rulings which are pertinent to a decision of the issue currently before this Court. Since the issuance of the ruling letter dated February 14, 1944, the Revenue Service has consistently held that a corporate parent which wishes to file a consolidated return with an insurance subsidiary may do so by filing appropriate consolidated fiscal year and short period returns in order to make the changeover. Had there been any variation in the Service's practice in

this regard, that variation would have been indicated in the Service's Precedent File. (Dep. 179.)

Later in this same discussion, the taxpayer "assumed" that, because it would have been physically impossible to read through all the material contained in the Service's general consolidated return file, this file is "nothing more than a temporary catchall depository". (Pltf. Br. 27.) This assumption on the part of the taxpayer is not warranted by any facts discussed in Assistant Commissioner Swartz's deposition, least of all by the physical impossibility of reviewing all the material in those files. Note, in particular, Commissioner Swartz' testimony (Dep. 34-35) regarding the Service's file index system.

D. *Taxpayer's Argument I D*

In this argument heading, the taxpayer protests that Assistant Commissioner Swartz did not make the file search for Government Exhibits 1 through 7 himself but, instead, asked one of his Senior Technical Advisors, Mr. Levine, to make the actual search. However, the taxpayer fails to show why a high Government official should have to make a file search personally. No one would expect a high corporate official to personally search his company's files for records which are in his custody and which a court wishes to examine; similarly, it is absurd to carp because a high Government official allowed a trusted subordinate to act on his behalf in searching files.

The taxpayer also complains that Assistant Commissioner Swartz gave Mr. Levine no specific instructions as to how this search should be made. But the taxpayer has failed to show why such instructions were needed. There has been no claim that Mr. Levine was incompetent, inexperienced, untrustworthy, or otherwise unequipped to make a search of the files and, in the absence of such a showing, the taxpayer cannot validly argue that Mr. Levine needed detailed instructions as to how to search through a set of files with which he was thoroughly familiar.

The taxpayer also attempts to multiply the issues before the Court by alleging that Assistant Commissioner Swartz' testimony as to the file search is hearsay. But to argue in this way is to miss the point that Assistant Commissioner Swartz is the official custodian of the files in question. The Assistant Commissioner may not have stood beside Mr. Levine and watched each step of the file search, but, as official custodian, he was certainly familiar with the way in which searches of his files were conducted in this and other instances. His experience and record with the Internal Revenue Service (Dep. 10-15) and the competence of his subsequent testimony leave little room for argument that he was unfamiliar with these matters. To argue that a busy official such as Assistant Commissioner Swartz should have stood idly by and watched a file search being conducted by a subordinate is even more outrageous than to argue that he erred in allowing a subordinate to search the files in the first place.

The taxpayer next seeks to attack the effectiveness of the Service's filing system on the ground that it failed to produce the ruling letter dated February 14, 1944, in time for the execution of the affidavit submitted by Assistant Commissioner Swartz earlier in the proceedings in the present case. The taxpayer conveniently overlooks Assistant Commissioner Swartz's testimony (Dep. 44-48, 50-51) which shows that, even if the Court does not have before it every ruling letter ever issued on the subject now at issue, it can rest reasonably assured that there are no outstanding rulings contrary to those presently before it. Assistant Commissioner Swartz' testimony in this regard is worth quoting (Dep. 50-51):

> **No one in the Income Tax Unit could have issued a ruling different or contrary or taken a different position than that letter without again having to refer this difference of a position back to the Chief Counsel or the Commissioner's Office, and at that point had any position been changed in this matter the file would**

have been removed from the Precedent File, and since the file still remained in the Precedent File and is still in the Precedent File it is an indication certainly that there is no probability that any contrary ruling was issued.

If there were any rulings that we don't have that were issued in this area, they would have been issued along the same lines. (Emphasis added.)

The conclusion that any unlocated rulings follow the principles outlined in the rulings presently before the Court is further borne out by the fact that there has been considerable continuity in the Service personnel who have handled the consolidated return problem. Between 1944 and the present time, only six people have worked in the Rulings Division as experts on consolidated returns (Dep. 106), and two of these six, Mr. Earl C. Heft and Mr. David Deutsch, have written all the rulings now before the Court, save the 1944 ruling. Five of the rulings were either written or reviewed by Mr. Heft. The issuance of aberrant rulings is therefore most unlikely.

The taxpayer concludes (Br. 30) by stating that "there are simply too many opportunities for error" in the Service's filing system and that, as a consequence, it is impossible for the Commissioner to maintain a consistent position on a particular subject. But the fact of the matter is that the Commissioner *has* maintained a consistent position on the consolidated return issue now before the Court for a period of more than 18 years, through changes of administration, reorganizations of the Internal Revenue Service, and reenactments of the provisions in the Internal Revenue Code. A filing system which, in spite of such changes, can maintain continuity of Service position in this fashion is certainly not defective.

The reason for the taxpayer's difficulties in understanding this point is that the taxpayer has not grasped, or chooses to ignore, the crucial significance of the Precedent

Files. The fact is that the materials in those files are supposed to be checked, and are checked, by Service personnel before writing a ruling letter (Dep. 33, 48), and that superseded materials are removed from those files when they become outdated or overruled (Dep. 48, 185-186).

E. *Taxpayer's Argument I E*

In this argument the taxpayer advances the view that there are so many contingencies involved in the Service's ruling process that it is uncertain that the Commissioner can maintain continuity of position in answering requests for rulings. (Pltf. Br. 31.) However, an examination of the facts presently before the Court clearly indicates that most of the taxpayer's alleged contingencies are fanciful. This can be illustrated most usefully by means of a diagram:

Plaintiff's Alleged Contingency	*The Facts*
If a ruling is selected for inclusion in the Precedent File • • •	Defendant's Exhibits 1, 2, 4, and 7 were placed in the precedent file. (Dep. 21, 23, 26, 32-33.)
If a subsequent request for ruling presents an identical or substantially similar fact situation • • •	A request from All-state-Sears would have presented a fact situation absolutely indistinguishable from that shown in Government Exhibit 5 and substantially similar to the situation shown in the other exhibits.
If the law and Regulations have not changed • • •	Taxpayer does not even urge that there was a material change of the pertinent law or Regulations from 1944 onward.
If the author of the current ruling checks the Precedent File • • •	It is the duty of ruling personnel to do so. (Dep. 33, 48.) There has been no proof of administrative irregularity.
If he approves the reasoning of the prior ruling • • •	Since 1944, no prior ruling has been disapproved. (Pltf. Ex. C; Dep. 47-48, 50-51.)

In addition to the concocted character of the "contingencies" just discussed, it is worth remembering the fact, discussed earlier, that Government Exhibits 1 through 7, Assistant Commissioner Swartz's deposition, and today's Regulations show that continuity of position has been maintained by the Revenue Service in this area for more than 18 years.[3] In the years from 1944 through 1956, this continuity of position was maintained with the aid of the filing system which the taxayer now finds so fraught with error. If the taxpayer's fancied contingencies had existed in fact, the Internal Revenue Service might not have been able to maintain a consistent position on this subject over a period of almost two decades.

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[3] It may be helpful to the Court to quote the present Regulations on this subject in full, since they succinctly state the policy first enunciated in 1944 in Government Exhibit 1 and consistently applied from that time forward. Section 1.502-14(c) of Treasury Regulations on Income Tax (1954 Code) reads as follows:

> SEC. 1.502-14 [as amended by T. D. 6412, 1959-2 Cum. Bull. 199] *Accounting Period of an Affiliated Group.*—
>
> • • •
>
> (c) If the common parent-corporation of an affiliated group has a fiscal year accounting period and any member of the group is an includible insurance company required by section 843 to file its return on a calendar year, *the first consolidated return which includes such insurance company may be filed on the basis of the fiscal year accounting period of the common parent*, provided, however, the common parent and the other includible corporations change to a calendar year basis effective immediately after the close of such fiscal year. For this purpose, Form 1128 shall be submitted at or before the time such first consolidated return is filed. (Emphasis added.)

In connection with the publication of this regulation, it is useful to recall the statement of the Court at the hearing in this case on December 11, 1961, regarding the possibility of administrative practice evolving into law. (Tr. December 11, 1961, p. 3.)

IV
REPLY TO TAXPAYER'S ARGUMENT II

Government's Exhibit 1:

Although the taxpayer claims that mere careful analysis of the rulings involved in this case is needed, the analysis which he offers of the ruling letter dated February 14, 1944 is seriously in error. Far from being a more careful analysis, the taxpayer's discussion of this ruling is based on a surprising misreading of this letter.

The Ruling Letter which has become Government Exhibit 1 was issued on February 14, 1944 in response to an inquiry from an Internal Revenue Agent. The agent questioned the correctness of a 1941 ruling which had permitted an insurance company to file fiscal year consolidated income tax returns with its parent. The Internal Revenue Service reconsidered its earlier ruling, and decided that it was incorrect. The result of this decision is diagramed in Chart I, Appendix, *infra*.

The thoroughness with which the Internal Revenue Service considered the question posed by the Internal Revenue Agent's inquiry is indicated by existence of the General Counsel's Memorandum, Number 24109, dated February 1, 1944, which has been introduced as Plaintiff's Exhibit C, and which expressed the concurrence of the Chief Counsel of the Internal Revenue Service in the issuance of the proposed ruling. It is important to compare what this February 1944 ruling letter *actually said* with what the taxpayer in its brief *says it said. The taxpayer states that* (Br. 35):

> • • • the Deputy Commissioner issued a ruling letter to the insurance company subsidiary revoking permission to adopt a fiscal year accounting period and stating that, *thereafter, no consolidated return would be accepted unless filed on a calendar year basis;* • • • (Emphasis added.)

As a matter of fact, the ruling letter actually granted permission to file *yet another* consolidated fiscal year return for the period ending November 30, 1944, including the income of the insurance company involved for the full twelve-month period from December 1, 1943 to November 30, 1944. The explicit words of the ruling are as follows (Deft. Ex. 1, p. 1):

> • • • Consolidated returns will be accepted for the fiscal years ended November 30, 1941, 1942, and 1943, *and the fiscal year ending November 30, 1944.* (Emphasis added.)

The fact that the taxpayer has erroneously described the February 1944 ruling letter is important because the taxpayer later asserts (Br. 57-66) that the fiscal year filing permission granted in the ruling letters dated August 21, 1951, and May 22, 1953 (Deft. Exs. 5, 6), was completely unprecedented. As the taxpayer surely realizes, the precedent for the granting of such permission lies in the 1944 ruling letter, now under discussion (and in the 1947 letter, which will be discussed below). *The whole point of the 1944 ruling is that the Service would not allow a permanent change of an insurance company's accounting period to a fiscal year, but would allow a fiscal year period as an interim measure* in the process of conforming the accounting periods of an insurance subsidiary and its parent corporation. This matter will be discussed again in connection with the 1951 and 1953 rulings.

The taxpayer's misreading of the 1944 letter is also significant in connection with their argument that Allstate-Sears could not have filed a consolidated return for 1950 after the passage of the Korean Excess Profits Tax Act on January 3, 1951. *The 1944 ruling letter shows that Allstate could have filed a consolidated return based on Sears' fiscal year ending January 31, 1951, had it chosen to do so.* To do this, Allstate would have filed a short period return for the month of January 1950, and Sears-

Allstate would have shifted to a calendar year basis by the submission of a short period return for the final eleven months of 1951, just as the companies involved in the 1944 ruling shifted to a calendar year basis by submitting a short period return for the month of December 1944. See Charts I and VIII, Appendix, *infra.*

The taxpayer summarizes its views on Government Exhibit 1 with a noteworthy compendium of erroneous statements. (Pltf. Br. 38.) The taxpayer first *states* that this exhibit "indicates that the Commissioner would not have allowed Allstate to adopt Sears' January 31 fiscal year for the purpose of filing a consolidated return". *In fact,* the exhibit indicates quite the contrary. *The ruling indicates that the Commissioner in January 1951 would have allowed Allstate to file a consolidated return based on its parent's fiscal year ending January 31, 1951,* just as the Commissioner in February 1944 allowed the taxpayer to file a consolidated return based on the parent's fiscal year ending November 1944.

The taxpayer next *states* (p. 38) that the 1944 ruling would have required submission of a request for change of accounting period by Sears at least 60 days before December 31, *1950. In fact,* the 1944 letter does not discuss requests for changes of accounting period, but it does indicate that permission to change to a calendar year effective December 31, 1944, should be obtained.[4] (See the last

[4] It is reasonably clear that the 60-day notice requirement applies to the change to the calendar year period *after* submission of the consolidated fiscal year return for the period ending November 30, 1944. When we apply this reasoning to the case at bar, we see that the 60-day notice requirement *applies to 1951, not 1950,* as alleged by the taxpayer. After submission of a consolidated fiscal year return by Allstate-Sears for the fiscal year ending January 31, 1951, Allstate-Sears would have to change to the calendar year effective December 31, 1951, and hence would have to file a request for change by November 1, 1951, *not* November 1, 1950.

paragraph of the ruling letter.) The taxpayer also concludes (Br. 38) that the 1944 ruling gives no assurance that the Commissioner will grant permission to change accounting periods. However, any fair reading of the 1944 letter clearly indicates that the Commissioner expects to approve a request for a change of accounting period, should the taxpayer choose to submit one.

The taxpayer next *states* (Br. 38) that it was too late for Sears to apply for permission to change accounting periods as of the date of passage of the Korean War Excess Profits Tax Act. This is a repetition of one of the taxpayer's erroneous lack-of-knowledge arguments, discussed earlier in this brief. This argument cannot change *the fact* that at any time prior to November 1, 1950, Sears could have applied for a change in accounting period which would have allowed it to conform with the accounting year of its subsidiary, Allstate, by filing a consolidated return on December 31, 1950. See alternative method Chart VIII, Appendix, *infra*. Nor can this argument change *the fact* that, subsequent to the passage of the Korean War Excess Profits Tax Act on January 3, 1951, Allstate could have filed a consolidated return to conform with the fiscal year of its parent Sears, ending January 31, 1951, provided that it then filed an amended return for January 1950 and (after Sears had requested and received permission to change to a calendar year effective December 31, 1951) a short period consolidated return with Sears for the remaining 11 months of 1951.[5] See Chart VIII, Appendix, *infra*.

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[5] Note that the Government believes that the practice is equally relevant to show the availability of either method to the taxpayer. The essential fact is that rather than being "hard-nosed" the Commissioner had "found a way out, the aim being to allow these corporations to file consolidated returns * * *." (Dep. 178.)

Finally, in its brief (p. 39), taxpayer repeats its assertion that the only question involved in this case is whether Allstate-Sears could have filed a consolidated return for Allstate's calendar year ending December 31, 1950. As pointed out earlier the real question is, whether Allstate-Sears could have begun to file a consolidated return in 1950 *or in any other year subsequent to 1944* and, alternatively, whether these companies could have filed a consolidated return on the basis of *Sears' fiscal year ending January 31, 1951.* The ruling letter dated February 14, 1944, clearly indicates that the answer to both these questioins must be "yes".

Government Exhibit 2:

Government Exhibit 2 is a ruling letter dated May 26, 1945, which was issued in response to a request from a taxpayer dated April 17, 1945 (which has now become Government Exhibit 2A). The April letter requested information as to whether a consolidated return could be filed for the period subsequent to the acquisition by the taxpayer of an insurance company subsidiary. The procedure permitted by this ruling letter is diagramed in Chart II, Appendix, *infra*.

The taxpayer attempts to show that the ruling letter contained in Defendant's Exhibit 2A contained only information already outlined in Sections 23.13 and 23.32 of Treasury Regulations 104 (1939 Code) entitled Consolidated Returns of Affiliated Railroad Corporations and Pan American Trade Corporations. Those Regulations indicate what is to be done when a parent corporation wishes to file a consolidated return with a subsidiary acquired at some time after the start of a taxable year. However, those Regulations do not cover, with any explicitness, when and how a corporate parent may file a consolidated return with

an *insurance* company subsidiary. This is indicated by the fact that the taxpayer who sent the letter which is Government Exhibit 2A found it necessary to request a ruling even though his letter of request indicates a very detailed knowledge of the consolidated return Regulations. The taxpayer points out that this ruling was not recommended for publication because, among other things, it was "Sufficiently covered by the regulations". (Dep. 91.) The Government suggests that, despite the taxpayer's desperate attacks, this ruling letter is most significant because it shows that the Bureau had adopted a policy of permitting parent corporations which own insurance company subsidiaries to file consolidated returns, provided that the parent took steps to conform its accounting period to the subsidiary's calendar year accounting period. The taxpayer's claim that the Government's Exhibit 2 does not represent a significant policy statement is especially strange in view of the fact that the Revenue Service chose this ruling for distribution to the field as Confidential Unpublished Ruling 1661. Far from failing to add anything new to existing policy, this ruling was considered sufficiently indicative of Service policy to justify distribution to the field offices of the Internal Revenue Service as a reference guide for revenue agents. (Dep. 57-59.)

Government Exhibit 3:

Government Exhibit 3 is a ruling letter dated September 12, 1945. Like Government Exhibit 2, it was written by Mr. Earl C. Heft. In this instance, a parent corporation had acquired an insurance company subsidiary shortly prior to requesting a ruling. The company wished to file a consolidated fiscal year return with its insurance subsidiary *as a permanent matter.* Since the request was for a permanent change, the Commissioner denied the corporation's request. This was, of course, fully in line with the

1944 ruling. This ruling is diagramed in Chart III, Appendix, *infra.*

The taxpayer *claims* that this ruling letter held that "under no circumstances will an insurance subsidiary be allowed to adopt a fiscal year accounting period for the purpose of filing a consolidated return with its parent". (Br. 46.) But where does the taxpayer find such a conclusion in this ruling letter? The words "under no circumstances" do not occur at any point in the letter. Moreover, it would be strange indeed if those words did occur because they would be inconsistent with the Service's position in its 1944 ruling letter (Government Exhibit 1) which permitted filing of a consolidated fiscal year return *in the year in which the affiliated group changed its accounting period.* What Government Exhibit 3 *in fact* holds is that an insurance company may not change to a fiscal year accounting period *as a permanent matter.* This holding is, of course, perfectly consistent with the granting of permission to file a consolidated fiscal year return *in the changeover year,* as was done in the 1944, 1947, 1951, 1953, and 1956 rulings, and as is currently allowed by Regulations, Section 1.1502-14(c).

The taxpayer's interpolation of words into Exhibit 3 which do not in fact appear in that ruling letter may be a result of its misreading of the ruling letter dated February 14, 1944, which, as will be remembered, permitted the filing of a consolidated fiscal year return for the years 1941, 1942, 1943 *and the fiscal year ending November 30, 1944* (1944 being the changeover year). Or it may be a result of the taxpayer's warm desire to prove that Allstate-Sears could not have filed a consolidated return for Sears fiscal year ending January 31, 1951. But neither of these factors can justify taxpayer's attempt to misstate what Government Exhibit 3 actually says.

The taxpayer also seeks to attack Government Exhibit 3 because it was not found in the general or Precedent Files of the Internal Revenue Service. However, there can be no question as to whether this ruling was in fact issued. First, Assistant Commissioner Swartz has so testified (Dep. 24); second, the taxpayer has so stipulated (Stip. filed November 6, 1961, Par. 1). Mr. Swartz assumed (Dep. 105) that this ruling might be from the files of a specialist in the Corporation Branch, but he also testified (Dep. 34-35, 44) that, although specialists files were scrutinized to get the names of rulings, those rulings were then further searched in the general and Precedent Files. In any event, there has been no showing that production of a document from a Revenue Service specialist's file is improper, provided the file was maintained in the normal course of the specialist's work as was the case here. (Dep. 105.)

Government Exhibit 4:

Government Exhibit 4 is a ruling letter, dated February 5, 1947, which was issued in response to a taxpayer request dated October 15, 1945. (Deft. Ex. 4 C.) The taxpayer in this instance reported income on the basis of a fiscal year ending September 30th. On July 1, 1946, it had acquired an insurance company on a calendar year basis with which it wished to file a consolidated return for all periods subsequent to the acquisition, *including the final quarter of the parent's fiscal year ending September 30, 1946. The ruling letter granted the taxpayer's request to file a consolidated fiscal year return,* including the income of the insurance company subsidiary in the income of the parent for July-September, 1946. Subsequently, the insurance company and the parent were to file a consolidated short period return covering October-December, 1946, thereby placing them both on a calendar year basis. See Chart IV, Appendix, *infra.*

The taxpayer in the present action claims (Br. 51) that this was "another instance in which the Commissioner changed his mind, in grappling with the consolidated return problem". The taxpayer bases his argument on the fact that an earlier letter dated October 10, 1946 (Government Exhibit 4 B) had been sent to the same taxpayer denying him the right to file a consolidated return with its insurance company subsidiary for the months of July, August, and September 1946. However, an examination of the circumstances surrounding the issuance of the letter of October 10, 1946, shows that it is unrealistic to view that letter as representative of a change in Service policy. The October 10th letter was written four days[6] after receipt of a taxpayer inquiry which had requested a reply "at the very earliest opportunity". (Government Exhibit 4 A.) Compliance with the taxpayer's request for a speedy reply may have made it impossible to review the October 10th letter as thoroughly as might otherwise have been the case, and may provide an explanation as to why Government Exhibit 4 B was issued. It is noteworthy that the October 10, 1946 letter was the only letter on this subject issued by the Internal Revenue Service in the decade from 1945 to 1955 which was not either written or reviewed by Mr. Earl C. Heft. However, Mr. Heft came into the picture when the taxpayer, dissatisfied with the answer which he received when he attempted to stampede the Service into

[6] Government Exhibit 4 A was stamped "received" on October 4, 1946; the block in the lower left hand corner of page 2 of Government Exhibit 4 B indicates that this letter was typed in final form on October 8, 1946. Hence, this letter could only have been the roughest sort of curbstone opinion designed to satisfy a taxpayer who wanted a quick answer.

issuing a ruling, requested a reconsideration of the Service's position. (Government Exhibit 4 C.) The ruling letter which was issued four months later was written by Mr. Heft and was entirely consistent with Service practice at all times from 1944 onward. Far from being an example of a case in which the Commissioner changed his mind, the letter of October 10, 1946, is an example of an instance in which the taxpayer gave the Commissioner too little time to make up his mind.

The taxpayer also seeks to show that the February 1947 ruling has no pertinence to the Allstate-Sears situation. (Br. 51.) But it is certainly whimsical to try to argue in this fashion, because, if the 1947 ruling indicates nothing else, it shows clearly that *the Commissioner was willing to permit a fiscal year return of a parent company to include the income of an insurance company subsidiary as a step to conforming the accounting periods of the two firms.*[7] In the Allstate-Sears situation, this can reasonably be interpreted to mean that the Commissioner would have permitted a consolidated return for the fiscal year ending January 31, 1951, provided that further steps were taken

[7]As the Income Tax Unit states in its memorandum to Chief Counsel on this ruling (Pltf. Ex. B):

> It appears that under a strict interpretation of the regulations a denial of the right to file a consolidated return for the above-mentioned year would be justified but in view of the circumstances in the case and the apparent desire of the companies involved to fulfil the requirements of the regulations with respect to filing consolidated returns, it is believed that the granting of such right would not jeopardize the Government's interest and that from an administrative standpoint the proposed ruling is sound.

to conform the accounting periods of the two companies as diagramed in Chart VIII, Appendix, *infra*.

Because the taxpayer fails to understand the point just outlined, he claims later in his brief (pp. 59-60) that he is astounded by the issuance in 1951 of the ruling letter which has become Government Exhibit 5. He goes so far as to claim that Exhibit 5 is in error because it permits an insurance company subsidiary to file a fiscal year return with its parent as a means of conforming the accounting years of the two companies. He also claims that the 1951 ruling could not have been predicted. Had taxpayer not misread Government Exhibit 1, and had it not been so intent on insisting that the 1947 ruling had no pertinence to a decision of the issues of this case, the taxpayer might have noted that the 1951 ruling grows naturally out of the provisions contained in the 1947 ruling letter, together with the 1944 ruling.

Government Exhibit 5:

Government Exhibit 5 is a ruling letter dated August 21, 1951. It was issued in response to a series of requests from a parent corporation which owned an insurance subsidiary and which wished to file consolidated returns with that subsidiary. The first of this series of requests was dated June 29, 1951 (see Government Exhibit 5 B). In it, the taxpayer requested permission to file a consolidated return for the fiscal year ending August 31, 1951. The taxpayer states that the proposal would include in the consolidated return the income of the insurance subsidiary only for the period from January 1, 1951 to August 31, 1951. (Br. 57.) However, a thorough reading of page 3 of the enclosure to Government Exhibit 5 B indicates that the writer of the letter also had in mind the possible inclusion of insurance

company income in the parent's tax return for the *full fiscal year* ending August 31, 1951.[8]

On July 25, 1951, the taxpayer submitted a second request, asking that it be granted permission to file consolidated fiscal year returns not only for the *full fiscal year* beginning September 1, 1950 and ending August 31, 1951, but also for the *full fiscai year* from September 1, 1949 to August 31, 1950. (Government Exhibit 5 A.)

The ruling letter issued in response to these two requests *granted permission to the entire corporate group to file consolidated returns for the full fiscal year ending August 31, 1950, and August 31, 1951.* See Chart V, Appendix *infra.* The ruling letter of August 21, 1951 makes clear that this especially generous treatment is permitted because of the unusual circumstances surrounding the delayed enactment of the Korean Excess Profits Tax Act of 1950 on

[8] The Government submits that this is just one more example of the taxpayer's attempt to misread the rulings in its favor. This consistent misreading is particularly ironic in view of the taxpayer's statement that (Br. 33-34):

> * * * we do promise that careful analysis will cut through the smoke screen with which the Government has surrounded these rulings * * *.

The Government submits that the "smoke screen" is the taxpayer's own creation. The Government originally wished to let the ruling letters speak for themselves. The taxpayer interpreted this as an invitation to twist and distort the plain meaning of the rulings' statements. The fact that a smoke screen *now* exists makes it all the more important for the Court to read each of these ruling letters for itself, asking, in particular, whether they show the existence of a practice under which, from 1944 forward, an insurance subsidiary could conform its accounting year with that of its parent *by filing a consolidated fiscal year return followed by a consolidated short period return to place the affiliated group on a calendar year basis.*

January 3, 1951. (Government Exhibit 5, p. 3.) In this respect, the lenient treatment given the taxpayer resembles that accorded to the taxpayer who received the 1944 ruling letter now contained in Government Exhibit 1. It will be recalled that, in that instance, the taxpayer had been filing returns in accordance with a 1941 ruling letter which the Commissioner wished to revoke.

On its facts, the ruling of August 31, 1951 is indistinguishable from the situation confronting Allstate-Sears in the years 1950 and 1951. In each instance, a question is involved as to whether a corporate insurance subsidiary can file a consolidated return with its parent. Each instance involves the enactment of the Korean War Excess Profits Tax Act of 1950 on January 3, 1951. Finally, in each instance, the insurance subsidiary had been owned by the parent company for a number of years prior to the request for permission to file consolidated returns. *Hence, the 1951 ruling letter is particularly indicative of what would have happened had Allstate-Sears chosen to file a consolidated return for Sears' fiscal year ending January 31, 1951.*

Because the taxpayer is unable to distinguish the 1951 ruling on its facts, he has been forced to argue that this ruling was erroneous and unprecedented. (Br. 60.) This argument is not convincing. First, an examination of the initials which appear on Defendant's Exhibits 2, 3, 4 and 5 indicates that all these ruling letters were drafted by the same person, namely, Mr. Earl C. Heft. It would be very strange indeed if, after having issued rulings in this area since 1945, Mr. Heft suddenly issued a ruling which was both erroneous and unprecedented. Second, the taxpayer's own cross examination of Assistant Commissioner Swartz pointed out that the writer and reviewers of this

ruling were aware of the existence of Government Exhibits 2 and 4 since references to these rulings were noted on the original signature page of Exhibit 5. (Dep. 128-130.)

The taxpayer's assertion that permission to file consolidated returns for the complete fiscal years ending August 31, 1950 and August 31, 1951 was unprecedented and unpredictable is a direct result of its misreading of Government Exhibits 1 and 4, as has been pointed out above. It will be recalled that in the February 1944 ruling letter (Government Ex. 1) the Commissioner granted permission to file a consolidated return with an insurance company subsidiary for the complete fiscal year ending November 30, 1944. In the 1947 letter permission to file a consolidated fiscal year return for July-September 1947 was granted. Here, the Commissioner similarly granted permission to file consolidated fiscal year returns, even though an insurance subsidiary's income was included in those returns.

The taxpayer seeks to make much of the fact that this ruling was not placed in the Precedent File. This only becomes a matter for surprise if, based upon a misreading of earlier rulings, the present ruling letter is regarded as a departure from prior precedents. However, there are sevral plausible reasons why this ruling letter was not placed in the Precedent File. First, Confidential Unpublished Ruling 1661 had already been distributed to the field when the 1951 ruling letter was written. Since this ruling letter was not in conflict with Confidential Unpublished Ruling 1661 and since the permission to file a consolidated return for a full fiscal year was in accord with the basic 1944 ruling, already in the Precedent File, there was no need to place the 1951 letter in the Precedent File. Second, the writer of this ruling, Mr. Earl C. Heft, apparently regarded this ruling as routine. (Dep. 133-134.) Since the views of the writers of rulings as to whether they shall be classified as precedents are given great weight (Dep. 22, 70), his decision on this matter prevailed.

In reality, the taxpayer is seeking to stigmatize as unpredictable each step by which a body of law has developed on the subject of the submission of consolidated returns where insurance company subsidiaries are involved. This taxpayer's accusation is as old as the common law itself but, fortunately, it has seldom been permitted to stifle the natural growth of a coherent body of legal doctrine.

The taxpayer also seeks to attack the 1951 ruling as in conflict with Sec. 29.46-1 of Treasury Regulations 111 (1939 Code) which requires submission of an application for change of accounting period when a parent conforms with the accounting year of its subsidiary. (Br. 60.) We fail to understand taxpayer's argument. This requirement of the Regulations applies *only when a parent changes to fit the accounting period of the subsidiary.* Treasury Regulations 129 (1939 Code), Sec. 24.14. Thus, this requirement would apply, under the facts of Exhibit 5, when the affiliated group changed to the calendar year *as of December 31, 1951,* not when the subsidiary changed to the fiscal year of the parent in 1950. See our discussion of this subject in footnote 4, *supra.*

The taxpayer also seeks to use Rev. Rul. 55-80, 1955-1 Cum. Bull. 387, as a means of arguing that the 1951 ruling letter was in error. Rev. Rul. 55-80 has already been discussed by the Government at pages 21-22 of its Brief in Opposition to Plaintiff's Motion to Strike. At that time, it was pointed out that Rev. Rul. 55-80 does not have any bearing on the question whether the Commissioner was correct in allowing insurance subsidiaries to file a consolidated fiscal year return with their parents as a first

step to conforming their accounting periods. The correctness of the Government's view on this matter is shown by the fact the Rev. Rul. 55-80 has not been modified or changed since the promulgation of Regulations Section 1.1502-14(C) by T.D. 6412, 1959-2 Cum. Bull. 199, as would certainly have been the case if the taxpayers were correct about the existence of a conflict between Rev. Rul. 55-80 and the practice now under consideration, because, as was pointed out in footnote 3, *supra,* Regulations Section 1.1502-14(C) codifies the practice shown in Government Exhibits 1 through 7.

The taxpayer also states (Br. 59) that there is no basis for the statement contained on page 2 of Defendant's Exhibit 5 that "it has been the policy of the Bureau in cases of this kind to permit the filing of the first consolidated return of an affiliated group upon the basis of the fiscal year of the common parent corporation". The taxpayer's argument on this point (Br. 58-59) fails to note the fact that Mr. Earl C. Heft, the individual who asserted that such a policy existed, had been writing the rulings in this area since 1945. In addition, the taxpayer's statement neglects the fact that Confidential Unpublished Ruling 1661 had been circulated to Internal Revenue Service field offices in 1947, thereby establishing a firm precedent within the Internal Revenue Service in dealing with cases of this kind.

The taxpayer also argues that the Commissioner was too lenient in this ruling. It may be, as Commissioner Swartz indicated in his deposition, that the Commissioner could have been "hard-nosed" and refused to permit the filing of consolidated returns under the circumstances here involved. (Dep. 178.) However, in view of the fact that the Commissioner of Internal Revenue had discretion which he could legitimately exercise in this area, it hardly lies

in the mouth of the taxpayer to complain that in the administration of the Internal Revenue laws the Commissioner was more lenient than he might have been, had he enforced the law in its full rigor. The correctness of the Commissioner's decision in favor of leniency is indicated by the fact that these very procedures have now been incorporated into the Regulations of the Internal Revenue Service. The taxpayer has not seen fit to challenge the correctness of the present Regulations even though they embody the same lenient policies which he now condemns as erroneous.

Finally, the taxpayer complains that his investigation of the origins of Defendant's Exhibit 5 has been hampered by the "cloak of executive privilege". (Br. 64.) However, taxpayer has not shown how any investigation which it has indicated a desire to make has been hampered by such a claim. Nor did anything in Taxpayer's Motion to Produce, filed on January 4, 1962, relate to Exhibit 5. In the absence of any showing by the taxpayer that his research has been hampered by a claim of executive privilege, it must be concluded that this plaint is baseless and hollow. The taxpayer also contends that Government Exhibit 5 is self-serving. (Br. 65.) Again, he completely fails to show how this allegation can possibly be true. Government Exhibit 5 was issued *ante litem motam,* and it is therefore fantastic to allege that this ruling letter was in some way issued as a means of preparing for the present litigation.

Government Exhibit 6:

Government Exhibit 6 is a letter dated May 22, 1953 which was issued in response to a request dated May 4, 1953 from a corporation which wished to file a consolidated return with its already acquired insurance company subsidiary. The ruling permitted the entire affiliated group, including the insurance company, to file a consoli-

dated fiscal year return for the entire fiscal year ended May 31, 1953. The subsidiary then filed an amended separate return for the period from January 1, 1952 to May 31, 1952 and the affiliated group filed a consolidated short period return for the period June 1, 1953 through December 31, 1953. See Chart VI, Appendix, *infra.*

The taxpayer claims that this letter ruling perpetuates the alleged error involved in the ruling letter of August 21, 1951 in that it permitted a parent with an insurance subsidiary to file a consolidated fiscal year return. The Government agrees that his ruling carries forward and perpetuates the policy and practice of the 1951 ruling. The taxpayer's difficulty is that it fails to understand the 1951 ruling—because it has failed to read the 1944 and 1947 rulings.

If this ruling were applied to the situation facing Allstate-Sears in the month of January 1951, *it is clear that permission would have been granted to those two companies to file a consolidated return for Sears' fiscal year ending January 31, 1951,* just as the two companies involved in Government Exhibit 6 were permitted to file a consolidated return for the parent's fiscal year ending May 31, 1953. Allstate would then have filed a separate amended return for the month of January 1950 just as the insurance company involved in Exhibit 6 filed a separate return for the period from January 1, 1952 through May 31, 1952; finally, Allstate-Sears would file a short period consolidated return for the last eleven months of 1951 just as the companies here involved filed a consolidated short period return for the last seven months of 1953. See Charts VI and VIII, Appendix, *infra.*

Hence, this ruling letter, far from perpetuating an error, simply applies the techniques for filing consolidated returns which were first developed in 1944 and which were so well exemplified in the 1947 and 1951 ruling letters. (Government Exs. 4 and 5.) [9] By use of these techniques, Allstate-Sears could have filed a consolidated return for Sears' fiscal year ending January 31, 1951, even if it took no action to file such a return until after the passage of the Korean Excess Profits Tax Act.

Government Exhibit 7:

Government Exhibit 7 is a letter dated January 18, 1956 to a parent company which had acquired an insurance subsidiary on January 1, 1955. The Commissioner ruled that the parent and the insurance company could file a consolidated return for the parent's fiscal year ending September 30, 1955 including the income from the subsidiary from January 1, 1955 forward. The affiliated group was then to file a consolidated short period return covering the last quarter of 1955 so as to place the entire affiliated corporate group on a calendar year basis. See Chart VII, Appendix, *infra.*

The taxpayer makes much of the fact that the Chief Counsel of the Internal Revenue Service expressed the view that this ruling should not be published because "the proper solution to the problem presented requires an amendment to the consolidated return regulations". (Pltf. Ex. A, final paragraph.) However, in making this argument, the taxpayer seriously misquotes the Chief Counsel. It is the taxpayer's claim, made first at page 68 and again at page 72 of its brief, that it was the Chief Counsel's view that "the *only* proper solution was a formal regulation". (Emphasis added.) However, reference to the phrase from taxpayer's own Exhibit A, quoted above, indicates that

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[9] These same techniques are, of course, now embodied in Regulations Section 1.1502-14(C). For a discussion of this matter see footnote 3, *supra.*

this is not what the Chief Counsel said. The taxpayer has cleverly distorted the Commissioner's statement by the addition of the single word "only"; the result of this distortion is to imply that the Chief Counsel felt the service's prior administrative solution to the consolidated return problem to be improper. This is certainly not the case, as the final paragraph of taxpayer's Exhibit A clearly indicates.

The taxpayer fails to note that the publication suggestion made by the Chief Counsel is yet another step in the natural process which began with the dispatch of the ruling letter dated February 14, 1944. Just as the Clifford Regulations evolved out of the prior case law and practice, and were subsequently enacted into statute law,[10] so, here, we see the slow but ordered development of a coherent body of doctrine regarding the filing of consolidated returns where insurance company subsidiaries are involved. It is entirely natural and correct that embodiment in Regulations should have been considered appropriate at some point in the development of this body of law. The Chief Counsel's memorandum shows that this point had been reached as of 1957 in connection with the administrative rules governing the submission of consolidated returns involving insurance company subsidiaries. Hence, far from showing that prior rulings were incorrect or improper, the Chief Counsel's recommendation shows that the law in this area was developing in a natural and orderly fashion.

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[10] The administration of the doctrine announced in 1940 by the Supreme Court in *Helvering* v. *Clifford*, 309 U.S. 331, caused so much difficulty that the Treasury eventually promulgated Sections 39.22(a)-21 and 39.22(a)-22 of Regulations 118. The 1954 Code enacted these Regulations into law. Secs. 671-675 and 678, Internal Revenue Code of 1954.

V

REPLY TO TAXPAYER'S ARGUMENT III

In this section of its brief the taxpayer admittedly repeats "matter [which] has been completely covered in the November 6, 14, and 17 briefs filed by the parties in connection with plaintiff's motion to strike Swartz' affidavit". (Pltf. Br. 71.) Because the taxpayer is repeating itself, the Government will give only a short reply.

The taxpayer again alleges (Br. 71-72) that the Federal Register Act and the Administrative Procedure Act state a policy against allowing unpublished administrative procedure "to be used against the public". Even if this statement were true, it misses the point—unpublished administrative procedure is not being "used against" Allstate-Sears in the present case. That corporate group is not being forced to file consolidated returns for the years involved; nor is any reliance interest of theirs in jeopardy. The Government offers proof of administrative practice in the Revenue Service only to show that *if Allstate-Sears had wished to file a consolidated return at any time after February 1944, it could have done so by following the same route that was used by the companies whose affairs are outlined in Government Exhibit 1 through 7 and Charts I through VII.* This being so, Allstate-Sears fails to qualify for the growth credit, irrespective of whether Allstate-Sears ever made application to file a consolidated return or wished to file such a return. To put the matter a different way, because Section 435(e)(1)(A)(i) of the Korean War Excess Profits Tax Act is couched in hypothetical terms, reliance is not an issue in this case.

The taxpayer concludes by attempting to generate fears as to what may happen if the Court finds for the Government on the issue of the existence of administrative practice. The taxpayer states that the effectiveness of the

Service's ruling procedure would be destroyed, but the taxpayer fails to show how this might occur. Whatever unnamed fears may affect the taxpayer apparently do not disturb the Commissioner of Internal Revenue with whose permission the testimony in the present case was taken.

VI

REPLY TO PARAGRAPH ONE OF TAXPAYER'S CONCLUSION

On page 16 of its brief, the taxpayer raises a question as to whether Assistant Commissioner Swartz was properly qualified as an expert on consolidated returns. On page 73, in paragraph one of the taxpayer's "conclusion" it is stated as a fact that the Assistant Commissioner was not qualified as an expert in the subject of consolidated returns. Between these two points in the brief there is no argument on this subject. To draw a conclusion from a question is surely a strange procedure.

The Government feels that the material contained at pages 10-15 of Assistant Commissioner Swartz' deposition amply qualifies him to testify as to the contents of Government Exhibits 1-7; this testimony shows that Assistant Commissioner Swartz is probably the most skillful person in the Nation in interpreting and describing Service practice in issuing rulings such as those involved here. The Commissioner is not a specialist in consolidated returns (Dep. 107), but he would not be Assistant Commissioner if he were. It is his broad experience with the Revenue Service over the past 26 years and his intimate day-to-day experience with the ruling process over the past decade which qualifies him to speak on the facts involved in this phase of the case. (Dep. 10-15.)

As to Assistant Commissioner Swartz' qualifications, the Government rests on his deposition testimony.

PROPOSED FINDINGS OF FACT

In light of the Government's proof of administrative practice in the Internal Revenue Service from 1944 until 1956, the Court is respectfully requested to make the following findings of fact:

1(a) Government Exhibits 1, 4, 5, 6, and 7, dated 1944, 1947, 1951, 1953, and 1956 respectively, and current Treasury Regulations 1.1502-14(c) all permit a consolidated return of an affiliated corporate group containing an insurance company to be filed on the basis of the fiscal year accounting period of the common parent, provided that this is done as an interim step in the process of shifting the entire affiliated group to a calendar year accounting basis.

1(b) Had the plaintiff, Allstate Insurance Company, and its corporate parent, Sears Roebuck and Company, requested permission to file a consolidated tax return subsequent to the passage of the Korean War Excess Profits Tax Act on January 3, 1951, permission to file a consolidated return based on Sears' fiscal year ending January 31, 1951 would have been granted, provided that this was done as an interim step in the process of shifting the entire affiliated group to a calendar year accounting basis.

2(a) Government Exhibit 2, dated 1945, permits an insurance company, formerly on a calendar year basis, and a parent corporation, formerly on a fiscal year basis, to file a consolidated short period return for the purpose of shifting the entire affiliated group to a calendar year basis.

2(b) If the plaintiff, Allstate Insurance Company, and its corporate parent, Sears Roebuck and Company, had timely requested permission to file a consolidated return at any time subsequent to the issuance of Government Ex-

hibit 2 in 1945, the Commissioner would have granted them permission to do so. The two companies could then have filed a consolidated short period return for the period from February 1 through December 31, and consolidated calendar year returns thereafter.

2(c) If, at any time in the year 1950 prior to November 1, the plaintiff, Allstate Insurance Company, and its corporate parent, Sears Roebuck and Company, had requested permission to file a consolidated return for the calendar year 1950, the Commissioner would have granted them permission to do so, using the method outlined in finding 2(b), above.

Respectfully submitted,

LOUIS F. OBERDORFER,
Assistant Attorney General.

EDWARD S. SMITH,
DAVID A. WILSON, JR.
THOMAS F. FIELD,
Attorneys,
Department of Justice,
Washington 25, D.C.

JAMES P. O'BRIEN,
United States Attorney.

MARCH, 1962

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 841-72

TAX ANALYSTS AND ADVOCATES, et al.,
Plaintiffs,

v.

INTERNAL REVENUE DEPARTMENT, et al.,
Defendants.

Washington, D. C.
Tuesday, December 5, 1972

Deposition of JOHN F. SIMMONS taken on behalf of the plaintiffs in the above-entitled action, at the Internal Revenue Service Building, Room 3419, Tenth Street and Pennsylvania Avenue, N. W., Washington, D. C., pursuant to notice, beginning at 10:07 o'clock, a.m., before Emma N. Lynn, a notary public in and for the District of Columbia, when were present on behalf of the respective parties:

For the Plaintiffs:
WILLIAM A. DOBROVIR, ESQ.,
2005 L Street, N. W.,
Washington, D. C.
THOMAS F. FIELD, ESQ.,
732 17th Street, N. W.,
Washington, D. C.

For the Defendants:
LOUIS J. LOMBARDO, ESQ., and
CHARLES E. STRATTON, ESQ.,
Tax Division,
Department of Justice,
Ninth and Pennsylvania Avenue, N. W.,
Washington, D. C.

— — —

PROCEEDINGS

Whereupon,

JOHN F. SIMMONS was called for examination by counsel for the plaintiffs, and having been first duly sworn by the notary public, was examined and testified as follows:

Examination by Counsel for the Plaintiffs.

By Mr. Dobrovir:

Q. Please state your full name.

A. John F. Simmons.

Q. And your present position in the Internal Revenue Service?

A. Chief of the Manual and Field Conference Section, Technical Services Branch, Technical Publications and Services Division, Internal Revenue Service.

Q. How long have you had that post?

A. Since 1965.

Q. Is it July 1965?

A. Yes, July '65.

Q. Would you trace your career in the Internal Revenue Service for us, giving posts and a brief description of the duties in those posts?

A. I came with the Internal Revenue Service in 1945, November, went to the Audit Review Division where I post reviewed revenue agents' reports.

About 1950, I went with the Executive Management Office of the Income Tax Division, doing administrative work as compared to technical work.

In 1952, in the reorganization of the Internal Revenue Service, I went with the Technical organization which was created at that time, and I have been with the Technical organization ever since then in various places in the organization, in that organization.

Q. And in the Technical organization since 1952, could you briefly describe your duties or functions?

A. I was with the Technical Planning Division for a short time.

I worked in the immediate Office of the Assistant Commissioner of Technical—let's see how long it was—for three or four years, I guess, on administrative work. And then I went with the Technical Projects Branch which prepares the booklets, *Your Federal Income Tax* and others. I did that type of work.

I guess I was with them until 1965 when the realignment of the Technical organization took place, when I took over my present position.

Q. What are your functions in your present position?

A. Well, I am the coordinator for all the procedures that go into Part XI of the Internal Revenue Manual.

Q. What are they?

A. Well, that is all the way from drafting procedures to work with or divisions in getting procedures ready where they are needed and coordinating with other organizations outside of Technical.

Q. When you say Part XI of the IRS Manual, what does that mean in terms of the organization of the manual?

Maybe you could tell us how the manual is organized.

A. There are 12 parts to the Internal Revenue Manual.

Technical has one part, and that is Part XI.

Part XI is divided into 11 chapters.

Do you want all the chapters?

Q. It might be helpful.

A. Chapter 000, Introduction to Part XI, IRM.

Chapter 100, Authorities and Standards.

Chapter 200, General Administration.

Chapter 300, Regulations and Legislation.

Chapter 400, Tax Forms Development.

Chapter 500, Technical Study Projects.

Chapter 600, Rulings, Determination Letters, Opinion Letters, Information Letters and Closing Agreements Covering Specific Matters.

Chapter 700, Technical Advice, Assistance and Information.

Chapter 800, Assistance to Other Offices.

Chapter 900, Revenue Rulings and Revenue Procedures.

Chapter (10)00, Technical Publications Program.

Chapter (11)00, Other Technical Programs and Services.

Q. And you are in charge of all of this Chapter XI, all 11 chapters?

A. Part XI.

Q. Part XI with all 11 subjects?

A. Yes. Eleven chapters.

Q. Now, is this Chapter 600, which deals with rulings and so forth—does that have instructions to agents on how—

A. Well, the procedures in Part XI concern primarily the Technical organization.

We don't have any field offices.

There are certain things in there that—all of the Internal Revenue personnel are governed by what is in there, of course, but it primarily is for the Technical organization.

There are some in there that concern the field.

Q. Does it contain guidelines or instructions to Internal Revenue personnel in the national office with respect to requests for rulings?

A. Yes.

Q. It does?

A. Yes.

Q. And does it instruct them how they are to proceed—

A. Right.

Q. —in connection with responding to a request for ruling?

A. Yes.

Q. And Chapter 700, does that contain instructions or guidelines with respect to how to handle requests for technical advice?

A. Right, yes.

I might mention that at this point there is no procedure in Chapter 700. We are developing it right now, and there is a group working on it, of which I am one.

In other words, it is being drafted. There is no material in Chapter 700.

Q. Chapter 700 doesn't exist yet?

A. It exists, but we have a comment in there that this material is being drafted because in other chapters we refer to 700, and so anybody that looks there sees there is a text material that says this text material is being drafted.

If we hadn't had a new Assistant Commissioner last spring, we probably would have had it out by now, but there has been—

Q. Part 600 is in final form though, Chapter 600?

A. There are changes going on all the time, but Chapter 600 is complete as of now.

Q. Does Chapter 600 itself contain any reference to the already existing files of rulings?

A. Yes.

It tells you that that form, M-3514, is an exhibit in Chapter 600, and there are certain questions on there that concern the files.

Q. Right.

But does it contain instructions or suggestions to the personnel with respect to how they should make use of the existing files of rulings?

A. I don't think 600 says so. I don't think there is anything in 600 that tells them how to use the files, no.

Q. Is there anything anywhere in Part XI which tells them how to use the files?

A. Yes.

We have a section on research facilities.

Q. And what chapter is that in?

A. That would be in Chapter 200.

Q. I see.

A. But Chapter 200 has a number of sections to it of miscellaneous materials if it doesn't fall into any of the other chapters.

Q. Does Chapter 200 have any material on how to use rulings files, and by rulings files I refer to the general rulings files of letter rulings and also to the digest card and reference card system?

A. It just says they are available. It doesn't—

Q. Does it describe them?

A. Yes.

Q. It does describe them?

A. Yes.

Q. And it says they are available to be used?

A. Right, yes.

Mr. Dobrovir: Do you have any objection to making the relevant sections that we are talking about part of the record, Mr. Lombardo?

Mr. Lombardo: I will have to thing about that.

Mr. Stratton: I don't think they have decided whether or not—

The Witness: Can I say something off the record?

Mr. Dobrovir: Off the record.

(Discussion off the record.)

Mr. Dobrovir: Back on the record.

By Mr. Dobrovir:

Q. Turning your attention to what I would describe, I guess, as the general file of letter rulings, could you describe what that file is physically to start with?

A. Well, there is not one file. Our Records Section consists of a number of files.

There is a file on revenue rulings and revenue procedures. In other words, every revenue ruling has a file.

You ask for a revenue ruling by number.

Say you want to see Revenue Ruling 69-172. They go to a certain section in the file room, and all the files are there numerically by revenue ruling number.

Then there is a Technical and General Correspondence file, and this file contains records from all the ruling branches in Technical, of which there are ten, and from our Technical Section that answers miscellaneous correspondence.

All this is in one big file. The ruling files are broken down by the ten ruling branches. Each ruling branch has its own section in this file room, and the reference files are in one place and the routine files are in another place.

So you have a number of files. You don't have one.

Q. The routine file is broken down by the ten rulings branches, and the reference file is also broken down by the ten rulings branches?

A. Yes.

Q. Could you list the ten rulings branches for us?

A. We have the Actuarial Branch, Administrative Provisions Branch, Estate and Gift Tax Branch, Exempt Organizations Branch, Excise Tax Branch, Pension Trust Branch.

They are all in the Miscellaneous and Special Provisions Tax Division.

We have the Corporation Tax Branch, the Engineering and Evaluation Branch, Individual Income Tax Branch, and Reorganization Branch, all in the Income Tax Division.

Q. Now, let's take the routine file.

How many file drawers are occupied by that file?

A. Well, we don't have file drawers. You have sections like that (indicating).

The files are in sections like that.

Q. In other words, they are stored sideways?

A. Yes, sideways, laterally.

Q. Could you give us an estimate of the magnitude of those files, let's say, in linear feet?

A. Well, let's see.

They are in rooms like this (indicating).

Q. Could you describe this room for the record?

A. I was talking of the number of bays. I would say there are about ten bays.

A bay would be from that partition to about here (indicating).

Q. Could you estimate it in feet, because the record won't show this (indicating)?

A. You want a total number of square feet in all the rooms?

Q. Just any kind of dimensions. That would be most helpful.

Mr. Lombardo: Perhaps you can say how high the bay is and how long each bay is.

The Witness: It goes up to the ceiling.

Mr. Lombardo: How high is that, ten feet?

The Witness: Well, there are about ten rooms, I guess.

By Mr. Dobrovir:

Q. Ten rooms, and the files cover all the walls of each one of these ten rooms?

A. They run across this way (indicating).

Q. They are on shelves?

A. Let me call the Records Section Chief. He may be able to tell me how many linear feet he has.

Mr. Dobrovir: Off the record.

(Discussion off the record.)

Mr. Dobrovir: Back on the record.

By Mr. Dobrovir:

Q. Could you give us an estimate of the magnitude of the routine and the reference file systems?

A. 6,760 linear feet, and that includes other files besides reference and routine.

For example, historical, closing agreement files, that is all included in that.

Q. And could you give us an estimate of how much of that 6,000 whatever it was—

A. 6,760.

Q. —linear feet are taken up by the routine and reference files?

A. No, I couldn't.

Q. Is it more than half?

A. I don't know.

For example, the Exempt Organizations Branch only has historical files in it.

Q. It has no routine rulings files?

A. No.

They keep everything because they found out they have to, and everything is in the historical file.

Q. So their rulings are all in their historical file?

A. Right.

But that doesn't mean that they are all indexed digested.

Q. I am aware of that.

It is only the reference files that are index digested.

Can you give us an estimate with respect specifically to the reference files, or are they all mixed up with the routine files?

A. No, the reference files are separate from the routine files.

Q. Could you give us an estimate on the reference files out of that 6,760 linear feet?

A. Well, it would be a pure guess. It wouldn't be an estimate of any kind.

I have gone into these files many times. But if you want a guess, I would say 2,000 feet for reference.

Q. Two thousand feet for reference?

A. Because I think there is less reference than there are routine and others such as historical. And it might be an overstatement. It might be overstating it.

Q. And you would say the routine files take up more space than the reference files do?

A. Right.

Q. So if it is 2,000 feet for reference, it is something more than that for the routine?

A. And historical and closing agreements and so forth.

Q. Let's try to leave out the historical and closing agreements for a minute.

But if it is 2,000 feet for reference, it might be, would you estimate, 3,000 feet for routine?

A. At least.

Q. At least.

So, the routine and reference files together, in your estimate, do take up the majority of the 6,760 linear feet?

A. No, because Exempt Organizations historical file is fairly large and maybe 2,000 feet for reference is overstated.

If you want the figures on that, I will have to call the Records Section Chief again, because I am not that familiar.

Like I say, I have been in there a number of times, but I don't know how many feet are set out for each file.

Mr. Dobrovir: Why don't we do that and we will continue the deposition while he is getting us those figures, go off the record, and ask him those questions.

(Short recess.)

Mr. Dobrovir: Back on the record.

By Mr. Dobrovir:

Q. How many people are employed in maintaining these files?

A. Sixteen.

Q. Sixteen people.

What is the highest grade of the persons in that position?

A. I will have to ask the Section Chief when I talk to him. He is the highest grade. I think he is, but I would rather ask him.

Q. Now, the maintenance of these files, is that under your supervision?

A. No.

Q. It is not under your supervision?

A. I am in the branch that the Records Section is in. There is a Records Section Chief and he is in charge of that. That is under our Branch Chief.

Q. And you are under the same Branch Chief that he is?

A. Right.

Q. Do you know how many people consult these files on a daily basis or every day how many people consult these files?

A. No.

Mr. Lombardo: May I interject.

Would you be specific as to what files?

Are you talking about routine files or are you just talking generally about all files?

Mr. Dobrovir: I wanted to find out if he has any knowledge, and then I was going to go on and be more specific.

We would like to know how many people consult the routine files each day on the average, and how many people consult the reference files each day on the average.

We also want to know where those people come from.

For example, are they from the Chief Counsel's office or are they from the rulings branches.

The Witness: Excuse me.

Mr. Dobrovir: Off the record.

(Discussion off the record.)

Mr. Dobrovir: Back on the record.

By Mr. Dobrovir:

Q. Do you have now an answer to the question I have asked previously?

A. Yes.

Mr. Lombardo: Before you answer the question, I want the record to show that this witness is relating this information from some third person and it is not of his own knowledge.

By Mr. Dobrovir:

Q. Would you tell us where you are getting this information from, Mr. Simmons?

A. From the Chief, Records Section, Vincent Keller.

Q. Can you give us a breakdown of the magnitude of the routine and reference files?

A. The reference file is 2,280, and in the routine file there is 4,480.

Historical and other files are all mixed in with these.

Q. Can you give us—

Mr. Field: Are those feet?

By Mr. Dobrovir:

Q. Are those linear feet of shelf space?

A. Right.

Q. Were you able to ascertain the grade levels of the people in that position?

A. Well, the grade level runs all the way from Grade 3 on up to Section Chief, who, I think, is an 11. I am not sure.

Q. And there are 16 people?

A. With one vacancy.

Q. Have you been able to ascertain how many people use these files?

A. On an average, 2,000 a month.

Q. An average of 2,000 a month.

Can you break that down by where they come from within the Service?

A. They don't know.

Q. They don't know.

Excuse me a minute.

Do you know whether these people come mainly from the national office?

A. Definitely.

Q. Now, focusing on the routine file, is there any kind of an index system?

A. No.

Q. If someone wants to find a ruling in the routine file, how would he do so?

A. He would have to know the taxpayer's name or the name of the case.

Q. And how would he find that out?

A. I don't know.

Q. Do you have any program for disposing of the material in the routine file?

A. Yes.

Q. And what is that program?

If you refer to something, Mr. Simmons, would you just state for the record what you are referring to?

A. Records Control Schedule 110, routine files are arranged in four-year blocks, and we dispose of a block after four years.

Q. How are the files arranged on the shelves?
A. By branch.
Q. But chronologically?
A. Alphabetically.
Q. How do you know a file is four years old?
A. They are arranged in four-year blocks.
Q. Within the alphabet?
Maybe you can explain this. I don't quite understand it.
A. Well, if you start in 1968, for a four-year block you would run 1968 through 1972, and at the end of 1972 you wouldn't immediately dispose of that block because some of the files would just be a few days old.
But that block would be disposed of after four years.
So, in 1976, I would say that entire group of files would be destroyed.
Q. Is that setting there on the shelf in one segment?
A. Right.
Q. And within that block it is filed alphabetically?
A. Right.
Q. So, in fact, the file is under, say, the Rulings Branch, let's say the Estate and Gift Tax Branch, and then you have files 1964-68 in one block filed alphabetically, and then 1968-72 filed alphabetically?
A. Right.
Q. And now it is 1972 and you are about, or you have just gotten rid of—
A. Of the '64-68.
Q. —the '64 to '68 block. I see.
When you dispose of them, are they burned or are they sent away somewhere?
A. I don't know.
Q. You don't know what happens to them?
A. I know they are sent to the Records Center for disposal.

Q. They are sent to the Records Center?
A. The Federal Records Center.
Q. You don't know if the Records Center keeps them?
A. No, they don't keep the routine ones. They destroy them.
Q. Do you have a program for disposal of the reference files?
A. Yes.
There is a program for disposal.
Q. Could you tell us what that program is?
A. Well, it is very detailed.
There are a number of breakdowns. In general, the files are disposed of after 40 years except selected records determined to have archival value which shall be transferred to the National Archives.
Q. Those are the reference files?
A. Yes.
Q. So there is a separate special program with respect to the reference files?
A. Right.
Q. How long has the reference files been maintained?
A. Well, I guess since 1913.
Q. Do you know that for a fact?
A. It started—this file that we now have was built up from 1952 from a number of different offices in the Internal Revenue Service. They came together into the technical organization, and each one of them brought their files with them.
These files go back—in fact, I was just looking at an index digest card this morning that was dated 1918.
So, I would assume that the files were started back in those days.
Q. But these were individual branches or office files which were gathered together in 1952?

A. When the Technical organization was created in 1952, a number of offices under Deputy Commissioners were brought together, the ones that did the rulings, the regulations work for those Deputy Commissioners came into Technical, and it was one organization, and these files were brought all together at that time.

Q. And at that time was it then called the precedent file?

A. Right.

Q. It first acquired the name precedent file in 1952?

A. No.

Q. But it existed prior to that but scattered around?

A. Wait a minute.

I don't know whether it had the name precedent before that or not.

It was just—I don't know whether the old Income Tax Unit file was called the precedent file or not.

Q. And were the rulings that were included in that file stamped precedent?

A. Yes.

Q. And were they stamped—did they carry this stamp prior to 1952 when they were gathered together?

A. I don't know.

Q. You don't know?

A. Not for sure.

Q. Was there any reason, to your knowledge, for gathering these files together in a single precedent file?

A. It was a continuation of the old files. The Income Tax Unit, the Miscellaneous Tax Unit brought their files together and, of course, the Income Tax Unit files were in the income tax area; the employment tax files were in the employment tax area; the excise tax files were in their area, but they were all in one unit, the Records Section.

Q. What was the purpose for maintaining the precedent file?

A. To have—at that time prior to 1952, they had issued copies of their rulings to the field to use, but starting in 1952 they didn't do it any more.

Q. They stopped it?

A. They stopped sending them out and started issuing revenue rulings at the beginning of 1953.

Q. And was that the reason why they put together this precedent file in the national office?

A. For what reason?

Q. Because they stopped issuing the rulings to the field.

A. No.

Q. Well, I am trying to find out why this precedent file was maintained.

What was the reason for maintaining this file?

A. Good business practice. You don't destroy your files. They keep having historical value and research value.

Q. But there was a distinction made between the precedent files and the routine files, is that not so?

A. Right.

Q. What was the reason for establishing that or for maintaining that distinction?

A. Well, the precedent files would eventually result in published rulings.

Q. It was expected that everything in the precedent file would eventually be published?

A. At that time, I was not that closely connected with it, but I would assume they had a form at that time where they indicated publication or non-publication.

If they indicated publication, it went to the precedent file. That would be my belief at this time, but I don't know. I wasn't that close to it.

Q. Is that what happens today?

A. Yes.

Q. I suppose this would be a good time to get into Form M-3514.

Now, this was Exhibit A to the deposition of Mr. Steinbuchel.

You have a copy of Form M-3514 before you?

A. Right.

Q. Could you tell us what this form is used for and how it is used?

A. A copy of this form is placed on incoming correspondence by our Communications Section, and it travels with the case wherever it goes until the outgoing correspondence is mailed.

It is then placed in the closed file of the Records Section, and along the way the people working on it indicate or check various blocks on here to indicate what they recommended.

Q. Well, let's go through this.

Now, the form contains a block for publication recommended, and that is No. 4?

A. Right.

Q. And the person working on the ruling is supposed to check either yes or no?

A. The person to whom the case is assigned indicates his recommendation by checking yes or no, that's right.

Q. And he is supposed to follow, in making that determination, and I am quoting from the back of this form, "Publication standards in Policy Statement P-(11)900-1."

Could you briefly tell us what those standards are?

A. They are published in Revenue Procedure 72-1, IRB No. 1972-1, January 3, 1972.

Q. Could you just summarize it for us?

A. Well, the shortest way to put it is that it is the policy of the Internal Revenue Service to publish all rulings and other communications to taxpayers or field offices involving substantive tax law or procedures affecting taxpayers' rights or duties except those involving, and then there are six exceptions:

One, issues specifically and clearly covered by statute or regulations.

Two, issues specifically covered by rulings, procedures, opinions or court decisions previously published in the Internal Revenue Bulletin.

Three, issues not likely to arise again because of unique or specific facts.

Four, determinations of fact rather than interpretations of law.

Five, informers and informers' rewards.

Or, six, disclosure of secret formulas, processes, business practices, and other similar information.

Now, there are two other exceptions in there that relate to alcohol and tobacco tax matters that have been transferred from Internal Revenue to another department. And if you read Revenue Procedure 72-1, you will find those two exceptions in there that no longer apply to the Internal Revenue.

Q. I notice on the form, under 4, there is a list of categories, A through H?

A. Right.

Q. Some of which were included in the things you just mentioned?

A. Right.

Q. One of them which is not is C, issues specifically covered by an open revenue ruling project.

What is that?

A. Well, if you are working on a proposed revenue ruling, and another letter ruling case comes along that is similar or the same as the open revenue ruling jacket, then this new case would be associated with the open revenue ruling project so that you wouldn't be issuing two or three revenue rulings all on the same thing.

Q. So, in other words, a determination has already been made to issue a revenue ruling on this particular subject matter?

A. Right.

Q. But it has not yet been issued?

A. Right.

It is in the process of being developed.

Q. About how long does it take from the commencement of an open revenue ruling project until the ruling is issued?

A. Well, I went over to our files the other day and made a little record of some of them.

Revenue Ruling 72-515 took three months. The letter ruling was issued July 19, 1972, and the revenue ruling was issued October 24, 1972.

Revenue Ruling 72-462 took six months. The letter ruling was issued April 10, 1972, and the revenue ruling, October 2, 1972.

Revenue Ruling 72-414 took one year and three months. The letter ruling was issued May 27, 1971, and the revenue ruling, August 28, 1972.

So, it varies from a few months to over a year.

Q. I see.

Now, while an open revenue ruling project is going on, if a request for a ruling comes in that is covered by that project, is there some way in which the person working on the case is informed of that?

A. Not unless he knew or had worked on the other one that he recommended for publication; but as it goes through the review process, it would come to somebody's attention, especially if it was recommended for publication.

When it got to the Project Section, they would know they had a revenue ruling project open and would recommend it be associated.

Q. In connection with issuing the particular letter ruling that is involved, would there be a decision made in the review process to have that letter ruling conform to the other letter rulings that had already been issued in that same project?

A. Well, if the same issue was involved, it should have the same answer, and it is up to the reviewers to see that it does.

Q. In other words, they maintain uniformity?

A. Yes, right.

Q. And that is not unique to open revenue ruling projects, I don't suppose?

A. No.

This is for everything. Even a routine ruling should be—

Q. They always want them to come out the same?

A. As close as possible.

Q. Well, how do you make sure they come out the same? What do you do?

A. This is up to the reviewers and the Branch Chief to see that they do.

Q. Do you know how the process works?

A. I guess it depends on the reviewers' knowledge. He is the expert in that area, and if one of the Tax Law Specialists under him writes a reply that is not consistent with what has gone out before, he would want to know why.

Q. Do they use the rulings files to make sure that they are being consistent with what has gone out before?

A. I don't know. I would say I don't think so because they couldn't go up to our Records Section every time they had a ruling to check to find out if this is what is going on.

They use their expertise and the knowledge that they have.

Q. In other words, they already know because they have been working in the field and know what has gone out before?

A. Yes, that would be my opinion.

Q. But the rulings files are there for them to use if they need them?

A. Yes.

The files are there for anyone in Technical to use.

Q. You mentioned before that about 2,000 people a month use those files.

What do they use them for?

A. Well, in some instances they would have a request from the same taxpayer and wanted to get the file out for that.

They may have found something that was similar to what they were working on and they wanted to associate it with the current case.

Q. About how many of those people actually use the index system?

Mr. Lombardo: I am going to make an objection to that. I don't believe this witness has that much knowledge about it.

You are asking him to speculate.

Mr. Dobrovir: We have had a very useful procedure in which when he doesn't know the answer to the question,

he can call up the people who do know the answer to the question. And I would be happy to continue to follow that procedure.

Mr. Lombardo: I don't want the deposition to indicate this man is testifying from his own memory.

He is just guessing.

Mr. Dobrovir: It is indicating when he gets information from the someone else, where he gets it.

Mr. Lombardo: I suggest the witness answer if he knows. If he doesn't know, I don't think he ought to speculate.

By Mr. Dobrovir:

Q. Do you think you could get an answer to the question of how many of those people actually use the index file?

A. Well, Mr. Keller said he didn't know how many used it.

Q. He said he didn't know how many used the index file?

A. Pardon me. I misunderstood your question.

Q. Of the 2,000 people who use the rulings files in the month, my question is, can you find out how many of those people use the index system?

A. I can find out how many people go in our Research Facility Section.

Whether they use the index digest card or not, or whether they go to some of the other books there, I don't think anyone would know.

Mr. Dobrovir: Perhaps you could find that out for us.

Off the record.

(Discussion off the record.)

Mr. Dobrovir: Back on the record.

By Mr. Dobrovir:

Q. Have you been able to ascertain how many people use the index card system?

A. Well, on the average of four or five hundred a month.

Mr. Dobrovir: Thank you.

Mr. Lombardo: Let the record show, please, where you got the information.

The Witness: It was obtained from Miss Josephine Murphy, Chief, Research Facilities Section.

By Mr. Dobrovir:

Q. Do you know why these four or five hundred people a month use the index system?

A. No.

Q. Now, continuing on with this form, we look on No. 6 and the first box to be checked is revenue ruling or procedure.

What does that mean?

A. Well, if a file results in a revenue ruling or revenue procedure, then the file is filed in that portion of the Records Section that contains the revenue rulings file.

Q. So that would mean it is either part of an open revenue ruling project or it is being marked, yes, publication recommended?

Do those things go together?

A. When it is finally determined that this is going to be a revenue ruling, they indicate here as to where the file should go, into which category.

Our Records Section people do not make the determination. Our technical people make the determination as to what kind of file it goes in.

Q. In other words, the man working on the case?

A. Yes.

Q. And he marks revenue ruling or procedure?

A. Right.

Q. The next box is reference.

What is the standard for a document filed reference?

A. If the case file has such significant future reference value because of the issues involved that it should be index digested by the Research Facilities Section, even though it does not meet the publication standards.

Q. Could you tell us what you are reading from?

A. Part XI of the manual.

Q. More specifically?

A. (11)633.82.

Off the record?

Mr. Dobrovir: Yes.

(Discussion off the record.)

Mr. Dobrovir: On the record.

By Mr. Dobrovir:

Q. Why don't you state for the record that it is on the form?

A. That information is on the reverse side of the form under instructions, Form M-3514.

Q. That instruction, which is Item 6(b), goes on and says, "that it should be index digested by the Research Facilities Section even though it does not meet the publication standards," and then it says, "Item 6(a) or 6(b) is also marked X to indicate the reason for classifying the case file reference."

Then it says, "The reference box is marked in relatively few cases."

Turning back to A and B, A says for future reference on same or similar issue where Item 4C, D, E or F is marked X. What does that mean?

A. Well, when you check any one of those subparagraphs, C, D, E or F, then the file has some future reference value because of its connection with future cases.

Q. C, D, E and F are reasons why publications should not be recommended?

A. Exactly.

If you want to retain the file, the only way you can keep it without it being destroyed is to put it in the reference file.

Q. The reason for having it in the reference file is so people can refer to it in the future?

A. Right.

Q. When they have the same or a similar issue?

A. Right.

Q. So they can know what the decision was before?

A. No.

If it is checked reference, it will be index digested.

There will be a card on it. So when they go to the Code Section it concerns, this file would be available by name.

So there is some value that the person working on the current case has in wanting to retain it when he checks Items C, D, E or F.

Q. He wants to retain it not merely for himself or for other people?

A. Right.

He figures that there is some future reference value to it, and this has to be concurred in by the reviewers all along the line.

Q. I see.

The reviewers all the way up the line have to concur in putting something in the reference file?

A. Right.

Q. I see.

Now, do you have any knowledge of how many of the items which are marked reference—how they are split up among those which are C or D or E or F?

A. No.

Q. You don't know that.

Who would know that?

A. I don't think anybody would know unless they went and looked at all the cards.

Q. I see.

In other words, the reviewers don't keep any track of that?

A. I don't think any statistics are kept as to how many items are checked A, B, C, D, E or F.

Q. The next thing that is referred to is 6B which says important research material in file.

Is that a reason for marking something reference?

A. Yes, it could be.

Q. And what would that be?

A. Files along the line that Mr. Steinbuchel—for example, if somebody made extensive research on an issue, and all the information was there, then they would want to retain it and have it available for other people.

Q. I would like to go on now to Item 7 on this form.

First, it says classification of any prior reference files having indistinguishable facts and contrary position.

Now, what is this—then it has A, transfer to routine or historical files, and B, retain as reference file.

Then, on the back, Item 7 has instructions, and it says, "See IRM (11)633.82:(6) for instructions as to entries in this item if the position taken in the current case is contrary to the position in a prior reference file having indistinguishable facts."

Could you tell us what this group of boxes and instructions is intended to deal with?

A. First of all, the reference should be to paragraph (7). This is a misprint.

Second, the only reason the instructions aren't on the form is we didn't have enough room, so we had to refer our people to the manual which has them.

Item 7 is completed only in cases in which the position taken in the current case is contrary to the position taken in a reference case or cases and in which the facts are indistinguishable. Somebody has made a mistake somewhere; a law has been changed.

Q. What happens at that point?

A. Then the person working on the current case indicates that the prior reference file should be transferred to routine or historical. And if that is the case, that is the final decision upon complete review, then when this form and the file get back to the Records Section, the people there use this information to take the case out of reference and put it into routine or historical, depending on what happened.

Q. So that is if the second decision is decided to be the right one?

A. Yes.

Q. What happens if, after looking at the reference file, the old decision is decided to be the right one?

A. Well, then the current case would be filed with the same thing.

In other words, that is still the position of the Service. There wasn't any change in law or anything else.

Q. In other words, the position of the second ruling would be changed to conform to the earlier reference ruling?

A. Right.

Mr. Stratton: I think you sort of put words into his mouth by phrasing that last question.

The Witness: Repeat the question.

Mr. Stratton: It was confusing to me.

Mr. Dobrovir: Let me try again.

By Mr. Dobrovir:

Q. If the second ruling is checked as having a contrary position to an earlier reference ruling, and it is decided in the review process that the earlier ruling is correct, then the later ruling, the one that we are going through, would be changed to conform to the earlier reference ruling?

Mr. Lombardo: I object.

I think there is an assumption in there that there is no testimony to.

In other words, the form says that if you come to a contrary position from an earlier one, then you have to indicate what is to happen to the earlier one.

But the contrary statement is not there. That is, if it happens that you come up with a position that is contrary to an earlier ruling, you have to change it back to the earlier ruling.

You are assuming that can occur. I don't think there is any testimony it is possible.

Mr. Dobrovir: That is exactly what my question is designed to find out.

Let me ask the question again.

By Mr. Dobrovir:

Q. Let us suppose that the person working on this case, having found a prior reference ruling, comes to a position contrary to the prior reference ruling.

Now, you testified, I believe, that sometimes the review process determines that the two rulings being contrary, the prior ruling was correct and should prevail.

Isn't that true?

A. Yes, that is true.

Q. My question is, when that determination has been made that the prior ruling is correct and should prevail, is the second ruling, the ruling that is being worked on, made to conform to the prior ruling in its result?

A. I would think it would. We are being uniform.

So, therefore, it would.

Q. You would not issue a ruling that is contrary to the prior ruling if the prior ruling has been determined to be the correct one?

A. Definitely.

Q. Thank you.

Now, if the prior ruling and the new ruling are contrary on indistinguishable facts, what would be the standards or criteria for determining that the prior ruling should be changed and that the new position of the Service should be the subsequent ruling?

A. I don't know. I could only surmise as to what that would be.

Q. Now, Mr. Simmons, are you in charge of preparing revenue rulings for publication?

A. No.

Q. You are not?

A. No.

Q. Do you have any functions at all in connection with the publication of revenue rulings?

A. No.

Q. So, all of your functions have to do with the manual?

A. Procedure, right.

Q. Now, are you familiar with the role of the Chief Counsel's office in the rulings process?

A. Yes, in a general way, what would relate to our procedures.

Q. What is the role of the Chief Counsel's office in the rulings process?

A. Like anyone else, asking for legal advice.

Q. What would be the criteria for asking for legal advice on a ruling?

How would, say, somebody in one of the rulings branches decide he wanted advice from the Chief Counsel's office?

A. Well, we have certain standards and they are in Part XI, but I don't know whether I can tell you what they are at this time until we decide whether Part XI is available or not.

Mr. Dobrovir: Would Mr. Lombardo like to comment on whether the witness can discuss that?

Mr. Lombardo: I think the same restriction applies on that as applied on the other part of the manual.

Mr. Dobrovir: We will wait and see.

Mr. Lombardo: Yes.

By Mr. Dobrovir:

Q. Mr. Steinbuchel testified that when a General Counsel's memorandum is issued in a case, he regards it as binding upon him and that it would always be followed.

Are you familiar with the process by which a General Counsel's memorandum is issued in response to a request?

A. I know that they are issued. I am not that closely connected with it.

Q. Do you know whether the issuance of a General Counsel's memorandum is one of the factors that would require the publication of a revenue ruling in that area?

A. No, I don't know.

Q. Have you taken a look recently at the index card system, Mr. Simmons?

A. Yes, I have looked at it.

Q. How recently have you taken a look at the system?

A. Nine o'clock this morning.

Q. And how thorough was your look?

A. I just looked at one code section.

Q. What code section was that?

A. 71(a) on alimony.

Q. Would you say that in addition to your look this morning you have a reasonably good familiarity with the contents of the system, the index card system?

A. Yes.

Q. Could you describe what appears on an index card?

A. It has got at the top, 1954 code, if that is the year of the code you are working on, has the taxpayer's name or other identification in the upper left corner.

In the upper right corner, it has the code section number, has the date, and in the center of the card it has a resume, a digest of whether it was, a court case or letter ruling, technical advice, and whatever it happened to be that was digested.

In the lower left corner, or on the back of the form, if necessary, at the end of the digest it has the organizational symbols of the people who issued that thing, and then it has notations at the bottom as to whether publication was recommended or not, and other pertinent information of various kinds.

Q. How many of those cards have any indication that another agency of the Government was communicated with in respect to that matter?

A. I don't know.

Q. On the basis of your familiarity with the card file, would you care to make an estimate?

A. No.

Q. Is it very few?

A. I couldn't even say.

Q. Are you familiar with any cards which have such a notation?

A. With another Government agency?

Q. Yes, sir.

A. That excludes Chief Counsel?

Q. Yes, sir.

A. I am sure that there are certain occasions that way, but I have never seen a notation that another Government agency has been—we write to other Government agencies.

So if that were the case that was decided, then that fact would be on the card. In other words, it would be up as a name, HEW.

Q. It would be HEW as the agency requesting the ruling?

A. Requesting the information.

Q. I see.

But if this were a card that referred to a ruling, a letter ruling, it would just have the taxpayer's name on it, not the name of an agency?

A. Right.

Q. Do you know approximately how many rulings each year are issued in response to a request by another agency of the Government?

A. No.

Q. Is it very few?

A. I would say yes, it is few in comparison to the total number issued.

Q. And are any of those rulings ever published?

A. I don't know.

I have never seen the card or know whether the ruling was published as a result of a request from another agency or not.

Q. Now, in your affidavit which was filed in this matter back in September, in referring to the digest cards in paragraph 5 of your affidavit, you say, "Many of these cards contain the names and addresses of taxpayers and confidential taxpayer information as well as interagency opinions, reasoning or conclusions."

What is the confidential taxpayer information that is included on the card?

A. I guess it was by chance that I looked at the alimony section 71 this morning, but one of the rulings in there I saw had to do with the husband claiming a deduction for alimony, a wife not including it as income.

The reason she didn't include it as income was because she said while they were separated, they still cohabited, and that was the basis for not reporting it as income.

I think this falls in the category of confidential taxpayer information.

Q. That kind of thing is unique to the alimony section, is it not?

A. Yes.

Well—

Q. At the time that you prepared your affidavit, before you had looked at the alimony section, what did you intend to mean by confidential taxpayer information?

A. Personally, I think anything the taxpayer tells the Internal Revenue in a request for a ruling is confidential.

It is not up to the Internal Revenue to tell a third party anything about that request at all, no matter how innocuous it may appear.

Q. In this sentence you go on to say, in discussing what these cards contain, "They contain interagency opinions, reasoning or conclusions."

What does that refer to?

A. Well, it would have in there if Chief Counsel had any comment to make on it. It may have some comment by a reviewer that was pertinent to it.

Q. How many of the cards which index letter rulings contain a reference to the Chief Counsel's opinion?

A. I don't know. I would have no way of knowing.

Q. Well, when you wrote this affidavit, you said that many of these cards contained that.

Mr. Stratton: Could you repeat that? Contained what?

Mr. Dobrovir: Interagency opinions, reasoning or conclusions, and among those the two examples Mr. Simmons cited were opinions from the Chief Counsel's office and comments by reviewers.

I am going through these two items one at a time, and I am asking how many of the cards contain reference to opinions of the Chief Counsel.

The Witness: I don't know how many were there. If the request had gone to Chief Counsel, then that information would be on the card.

By Mr. Dobrovir:

Q. Well, when you wrote this affidavit, did you write it on the basis of an examination of the card file?

A. No.

Q. You did not.

On what basis did you make this statement?

A. Just general knowledge of things that are in it.

Q. General knowledge?

A. I have not counted the cards or looked at all the cards to see that more than 50 percent of them contain this type of information.

Q. When you prepared the affidavit and in connection with its preparation, did you go and look at the card file system?

A. Not immediately before preparing this, no.

But I had looked at it over the years, been down there many times.

Q. So this was based on—

A. General knowledge of the system as I have seen it.

Q. Can you tell us how many of those cards, in fact, contain a reference to the comments of the reviewer?

A. No.

It is on the same basis.

Q. Now, turning to paragraph 6 of your affidavit, you say in connection with the reference file the use of the term precedent was discontinued prior to the period July 26, 1968, for which plaintiffs seek records.

When was the use of the term precedent discontinued?

A. In 1967.

Q. And what was the reason for discontinuing the use of that term?

A. The Freedom of Information Act.

Q. Would you explain that?

A. Well, in looking through the file, the term precedent was not applicable.

The word reference more aptly explained the file.

It probably should have been changed before that because it wasn't a true precedent file.

Q. The word precedent had been used since 1952?

A. Nobody had bothered to change it. It was just one of those things that continued on until—

Q. And how the Freedom of Information Act cause you to change it?

A. Because I guess there are things in there that were not precedent, and precedent had to be published.

Q. So, in other words, when the Freedom of Information Act was passed, you changed the name of the file so that it wouldn't be covered by the Freedom of Information Act, is that correct?

A. No.

We just changed the name of it. The name reference is more applicable than the word precedent.

Q. Who was involved in deciding to change the name?

A. I guess practically everybody in Technical from the people working on the drafting to procedures up to the Assistant Commissioner who made the final decision.

Q. So the Assistant Commissioner did make the final decision?

A. Yes.

Q. Prior to the passage of the Freedom of Information Act, was it a matter of discussion in your office?

A. I don't think anybody ever thought about the word precedent until the Freedom of Information Act came in.

Q. No.

My question was, was the Freedom of Information Act itself, or the bills that were pending in the Congress, a matter of discussion in your office?

A. Not to my knowledge, not before 1967.

I became involved in early '67. Before that, I don't know.

Q. How did you first become involved with the Freedom of Information Act?

A. Well, I was made the representative from my division to be on the group that was working on any changes we had to make as a result of the Freedom of Information Act.

Q. Was this before or after the passage of the Act?

A. It was passed in July of '67, and this was a few months before that.

Q. And what did this group do?

A. Well, we had to look through all of our procedures, policy statements and everything else to see what could or could not be made available under the Freedom of Information Act, whether it was exempt under any of the nine exemptions.

Q. This was before the Act was finally passed, is that correct?

A. Yes.

Q. Was there any—

Mr. Lombardo: Let me interject.

I think you are confusing the witness.

The original Act was passed in 1966. It didn't go into effect until 1967.

Mr. Dobrovir: I am sorry.

I got the dates wrong. Let me go back.

By Mr. Dobrovir:

Q. Are we talking about 1967 after the Act was passed or 1966 before it was passed?

A. It was passed in '66, to be effective July 4, 1967?

Mr. Field: Right.

The Witness: This was in early '67, I guess, that I became involved.

By Mr. Dobrovir:

Q. So this was after the Act had been passed?

A. But before it became effective.

Q. And what did your group do?

A. There was an Internal Revenue group. I was part of the group for Technical, and everybody went over their records to see what would or would not be made available under the Freedom of Information Act, just how we stood.

Q. And it was in the course of that process that the decision was made to change the name of the precedent file to reference?

A. That was one of the things, yes.

Q. Was one of the decisions made to restamp all of the rulings in the file?

A. That was done as the files—we didn't go through all the files right away and change it. But as that file was pulled out for some reason, the Records Section would change the stamp.

Mr. Dobrovir: I am going to show you a document which we will make Exhibit A to your deposition.

(The document referred to was marked for identification as Exhibit A.)

Mr. Dobrovir: I only have the one copy because of a reason you will see.

It is a letter ruling, Exempt Organizations Branch, from the District Director in Manhattan to something called Tax Foundation, Incorporated. It is dated November 16, 1965. And it has on its face at the bottom a stamp, "Reference, Internal Revenue—Technical," and it has next to that a blocked out stamp which is very difficult to read. It seems to have been overstamped.

By Mr. Dobrovir:

Q. Do you think you could look at this and tell us what is under the overstamped block on the right-hand side?

A. Can I talk to my attorney?

Mr. Dobrovir: Of course, on the record.

The Witness: What is that?

Mr. Lombardo: That is all right. You don't have to confer with us.

Mr. Stratton: I think we should object to introducing this as an exhibit.

This is a confidential private letter ruling.

Mr. Lombardo: We are not making it public. He is making it public.

We don't worry about it.

If you know the answer, you can answer the question. If you have seen that document before, answer the question.

The Witness: This stamp was precedent before it was blocked out.

Mr. Lombardo: Are you confident that was so, or was that the practice?

The Witness: That was the practice. I will assume that the word precedent was here before it was stamped reference.

Mr. Lombardo: May I interject.

You can't testify here you have ever seen this specific document before, have you?

The Witness: I have seen this particular—this was made from the official file copy, the yellow copy that is in our official records, and I have seen the actual yellow copy that this was made from.

Mr. Lombardo: How did that come to your attention?

The Witness: Because it is Exhibit 14 in one of the documents filed by Tax Analysts and Advocates.

By Mr. Dobrovir:

Q. You were able to go back and find that file and ascertain there is such a ruling in the files, is that correct?

A. Yes.

I got the name of the taxpayer.

Q. And so you have examined the original document in the file, and it shows that the word precedent was stamped over the word reference stamped on?

A. No.

You cannot see the word precedent. It is a black stamp stamped over it. But our procedure at the time was that the word precedent would be blocked out, and it would be restamped reference.

Mr. Field: You want to give it to the reporter?

Mr. Dobrovir: I am going to give it to the reporter.

I have no more questions, but let the record show that counsel for defendants and I as counsel for plaintiffs have agreed that if Part XI of the Internal Revenue Service Manual is made public or if it is not being made public, and those portions which are relevant to the subject matter of this lawsuit are made available to plaintiffs for the purpose of this lawsuit, then Mr. Simmons will be recalled.

So, for that purpose, and for that purpose only, plaintiffs would adjourn rather than terminate the deposition of Mr. Simmons.

Does that reflect our stipulation?

Mr. Lombardo: That is correct.

The date will be set at some future time.

Mr. Dobrovir: Yes.

If Part XI or parts of Part XI are produced, we will mark them Exhibit B to the deposition.

Mr. Field: If that is agreeable to counsel for the defendants.

Mr. Lombardo: I have no objection to what you mark as an exhibit if it is available.

Mr. Dobrovir: Fine.

Mr. Lombardo: Mr. Stratton will ask some questions.

Examination by Counsel for the Defendants.

By Mr. Stratton:

Q. Mr. Simmons, earlier you testified that if there was a prior private letter ruling issued in a certain area, that the new ruling should reflect the same answer.

Is this so because the new ruling should follow the old ruling, or is it so because the principle involved is the same?

If they are identical facts, then the principle should hold true for the second ruling?

A. The principle should hold true uniformly. It would be the same to that extent.

Q. Did you base this answer because the prior ruling should be followed, or is it because the actual principles involved hold true?

A. There is a position we followed, and that prior ruling was based on the position and, therefore, the current ruling should also be based on the same position.

Q. You also, in your affidavit, referring to paragraph 5, said that the card summaries contain certain confidential taxpayer information.

Now, when you made your affidavit, you were referring to this present case concerning section 613(c) of the Internal Revenue Code.

Did you examine the cards pertaining to that section?

A. It wasn't in reference to section 613(c). I was not going by just section 613(c).

I think the date of my deposition—they expanded their original suit to cover more than just 613(c), and I was talking in a general way about the entire index digest file.

Q. But did you examine the cards concerning 613(c)?

A. I have looked at them, yes.

Q. Do some of these cards contain trade secrets or secret processes?

A. Well, I think anything that the taxpayer tells us is confidential or secret as far as that goes.

As to whether there is by legal definition a trade secret or not, I don't know whether there is any such thing as that in the file.

Q. Do some of these card summaries contain, let's say, processes that a certain company would use in mining?

A. Yes, they do.

Q. So, in your opinion, these could be considered trade secrets?

A. Yes. In my opinion, they would.

Q. Do they contain financial figures or figures that would, in your opinion, be confidential?

A. If there were any dollar amounts in there, they would be, in my opinion, confidential.

I can't recall offhand whether there were any actual dollar amounts in those ones in section 613(c).

Q. You also testified that they contained interagency opinions, reasoning or conclusions.

On these cards is there reasoning of the person who prepared the actual private letter ruling contained in the card summary?

A. It was in the digest in a digest manner.

Q. You said also there is the reasoning of the reviewer contained in the digest cards?

A. I don't know. I can't—

Q. Certainly the conclusion of the preparer would be contained in the summary of the digest cards?

A. Whatever was in the digest was the final answer that went out, and that would be everybody's opinion along the line.

Q. Would that contain the reasoning of the preparer and the reasoning of the reviewer?

A. In a digested way, yes.

Q. Plaintiffs' Exhibit A to this deposition was also Plaintiffs' Exhibit 14 you referred to?

A. Exhibit A—was that the M-3514?

Q. Exhibit A was the private letter.

A. Yes, to my deposition, okay.

Same as Exhibit 14.

Q. You said that is a file copy, internal file copy?

A. That is an identical copy of our official file copy, the yellow copy.

That reference stamp and blocked out precedent stamp appears only on the official file copy.

Q. Do you have any knowledge of how that copy could have gotten out of the file?

A. No.

It was, in my opinion, illegally obtained because no one should have this but our Records Section.

Q. That is not a copy that would be issued to a taxpayer?

A. No.

Q. That is an internal file copy?

A. Yes.

Q. Would it be only Internal Revenue Service personnel who would have access to that particular copy?

A. That's right.

Mr. Stratton: No further questions.

Mr. Dobrovir: I have just a few more on redirect.

Further Examination by Counsel for the Plaintiffs.

By Mr. Dobrovir:

Q. In response to Mr. Stratton's questions about what is on the card summary, I believe you testified—strike that.

Let me ask you this.

Have you ever seen a card summary in which a technical process was described?

A. Yes.

Q. Was the technical process described in terms of how it worked or was there simply a reference to the fact there was a technical process?

A. Well, it explained in some detail how the process worked.

Q. I see.

Have you ever seen a card summary which had dollar figures on it?

A. I can't say positively.

I am sure I have, but I can't say which one or where I saw it.

Q. If there were a card summary which contained dollar figures, would it be easy to block those figures off if the file were to be made public?

A. No, it would not be easy.

Q. Could it not simply be done with white-out?

A. Then you destroy the card.

Q. Could you make a Xerox of the card and then cover the figures with white-out?

A. Then you can read it from the reverse side.

The only way you can do it is to make a copy of that card and then cut out that figure.

Q. So there is a way to do it?

A. Yes.

Q. Now, you were asked, I believe, whether the cards contained the opinion of the reviewer.

Have you ever seen a card in which the opinion or the comments of the reviewer were identified as such?

A. I can't say that I have.

Q. Do you believe that there are cards in which the opinion of the reviewer is identified as the opinion of the reviewer as distinguished from the opinion of the preparer?

A. I can't answer that. I don't know.

Q. Isn't it usual that the letter ruling itself simply states the conclusion without distinguishing whether it is the conclusion of the reviewer or of the preparer?

A. I would say in general that is right.

Q. Have you ever seen a letter ruling in which the opinion of the reviewer is identified?

A. In the file.

Q. In the letter ruling?

A. Not in the letter ruling to the taxpayer, no. It wouldn't be, certainly not in here.

Mr. Dobrovir: I have no more questions.

Mr. Lombardo: We have no questions.

(Witness excused.)

(Whereupon, at 12:02 o'clock p.m., the taking of the deposition was concluded.)

I have read the foregoing 67 pages, which contain a correct transcript of the answers made by me to the questions therein recorded.

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John F. Simmons

Subscribed and sworn to before me this ..... day of ....., 197.....

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Notary Public

My commission expires .....

CERTIFICATE OF NOTARY PUBLIC

I, Emma N. Lynn, the officer before whom the foregoing deposition was taken, do hereby certify that the witness whose testimony appears in the foregoing deposition was duly sworn by me; that the testimony of said witness was taken by me stenographically and thereafter reduced to typewriting under my direction; that said deposition is a true record of the testimony given by said witness; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this deposition was taken; and, further, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of the action.

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Notary Public in and for
the District of Columbia

My commission expires January 14, 1975.